

APPENDIX A – THE AUDIT RISK MODEL

INDEPENDENT AUDITS OF FINANCIAL STATEMENTS

1 Publicly held companies and other entities (referred to in this report as *public companies* or *public entities*) are required by securities laws to file with the Securities and Exchange Commission (SEC) financial statements audited by independent auditors. Most users of financial statements are aware that such audits are being performed and that auditors issue reports that conclude with an opinion on whether the financial statements are in conformity with “generally accepted accounting principles” (GAAP).¹ GAAP is a technical accounting term that encompasses the conventions, rules and procedures necessary to define accepted accounting practice at a particular time. In general, the Financial Accounting Standards Board is the body that promulgates GAAP.

2 All auditors are required to perform audits in accordance with “generally accepted auditing standards” (GAAS).² The Auditing Standards Board (ASB) of the AICPA promulgates GAAS. The SEC historically has accepted GAAS as necessary and sufficient to comply with the requirements of the securities laws that call for independent audits of financial statements.

3 Audit firms are engaged by their clients (i.e., the preparers of financial statements) to perform audits. The management of a publicly held company is responsible for the preparation of the company’s financial statements. Auditors are responsible for carrying out their audits of those financial statements in accordance with GAAS, which state that auditors are responsible for planning and performing their audits to obtain *reasonable, though not absolute, assurance* about whether the financial statements are free of *material* misstatement, whether caused by error or fraud. The purpose of independent audits therefore is not to produce financial statements but rather to enhance their reliability.

THE AUDIT RISK MODEL

Overview of the Model

4 GAAS establish a “model” for carrying out audits that requires auditors to use their judgment in assessing risks and then in deciding what procedures to carry out. This model often is referred to as the “audit risk model.” The model allows auditors to take a variety of circumstances into account in selecting an audit approach. For example, the model calls for auditors to have an understanding of the client’s business and industry, the systems employed to process transactions, the quality of personnel involved in

¹ To distinguish GAAP or GAAS in the United States from accounting or auditing standards outside of the United States, these terms are sometimes modified as U.S. GAAP and U.S. GAAS (see Chapter 7).

² See note 1.

accounting functions, the client's policies and procedures related to the preparation of financial statements, and much more. The model requires auditors to gain an understanding of a company's internal control, and to test the effectiveness of controls if the auditor intends to rely on them when considering the nature, timing and extent of the substantive tests to be carried out. For example, if controls over sales and accounts receivable are strong, the auditor might send a limited number of accounts receivable confirmation requests at an interim date and rely on the controls and certain other tests for updating the accounts to year end. Conversely, if controls are not strong, the auditor might send a larger number of accounts receivable confirmations at year end. The model requires an assessment of the risk of fraud (intentional misstatements of financial statements) in every audit.

5 Based on the auditor's assessment of various risks and any tests of controls, the auditor makes judgments about the kinds of evidence (from sources that are internal or external to the client's organization) needed to achieve "reasonable assurance." On the one hand, GAAS set forth numerous requirements or matters that auditors should consider; on the other hand, the need to exercise audit judgment is embedded throughout GAAS.

Technical Briefing About the Model

6 Statement on Auditing Standards (SAS) No. 47, *Audit Risk and Materiality in Conducting an Audit*, essentially provides the high-level conceptual underpinning for the audit risk model, but the concepts in the model permeate GAAS. For example, the model directly influences audit sampling, which is the application of an audit procedure to less than 100% of the items in a given population for the purpose of evaluating some characteristics of the population.

7 Audit risk (AR) is the risk that the auditor may unknowingly fail to appropriately modify his or her opinion on financial statements that are materially misstated. Audit risk is the *product* of the following three interrelated factors:

IR = Inherent risk (the risk that an assertion is susceptible to a material misstatement, assuming there are no related controls)

CR = Control risk (the risk that a material misstatement that could occur in an assertion will not be prevented or detected on a timely basis by the entity's internal control)

DR = Detection risk (the risk that the auditor will not detect a material misstatement that exists in an assertion)

8 Thus, the "mathematical" depiction of the audit risk model in simple terms is $AR = IR \times CR \times DR$. Despite the precision implied by rendering the model in mathematical terms, in reality it is highly judgmental. The objective in an audit is to limit audit risk (AR) to a low level, as judged by the auditor.

9 Essentially this objective is accomplished as follows. Auditors are required to assess inherent risk (IR) and control risk (CR) along a spectrum. Often in practice this assessment is reduced to three levels: maximum risk, moderate risk or low risk (or similar terms, such as high, medium or low risk). These assessments are complex matters to carry out, and GAAS set forth a number of requirements on how to accomplish them at both the financial statement level and the individual account balance or class of transactions level. GAAS also contain a specific requirement that, if control risk is to be assessed at less than the maximum level, the auditor must test the effectiveness of controls to support that assessment. A maximum risk assessment (i.e., 100%) means that the auditor believes controls are unlikely to pertain to an assertion or are unlikely to be effective, or the evaluation of their effectiveness would be inefficient. In all cases, the auditor is permitted to “default” to a maximum risk assessment for inherent or control risk.

10 The importance of the assessments of inherent and control risk is highlighted by their effects on detection risk (DR). The effects can be depicted in mathematical form by the equation $DR = AR / (IR \times CR)$. The auditor mitigates or compensates for the assessed levels of risk by designing and performing procedures to detect material misstatements. The greater the inherent and control risks, the lower the detection risk needs to be, resulting in “more” procedures (“more” includes their nature and timing as well as their extent) that the auditor would need to carry out. At the end of the day, the objective is to limit audit risk to an appropriately low level, thus enabling the auditor to achieve *reasonable assurance* that the financial statements are free of material misstatement.

11 Some added observations about what the audit risk model contains and does not contain are worthy of discussion. First, the model subsumes the concept of “materiality.” Auditors do not have to concern themselves with every possible misstatement of a financial statement that might occur. Consequently, the concept of materiality enters into the risk assessment process, and the selection of the nature, timing and extent of the audit procedures is an integral part of the model. Furthermore, the model calls for auditors to make “fraud risk” assessments that encompass attributes of both inherent and control risk.

12 Lastly, the auditor also is exposed to risks that are not embraced in the audit risk model. For example, auditors may be exposed to loss or injury to their professional practice from litigation, adverse publicity or other events arising in connection with financial statements they audited and reported on. This exposure is present even though the auditor has performed the audit in accordance with GAAS and has reported appropriately on the financial statements. Even if the auditor assesses this exposure as low, the auditor is not permitted to perform less extensive procedures than otherwise would be appropriate under GAAS. The “risks” that fall outside of the audit risk model generally are referred to as “engagement risk,” “client risk” or “client continuance (or acceptance) risk.”

Historical Perspective of the Model in GAAS

13 The audit risk model is codified in GAAS (although not by name), primarily in SAS No. 47. The ASB issued SAS No. 47 in 1983, and it was amended in 1997 by SAS No. 82, *Consideration of Fraud in a Financial Statement Audit*. Prior to SAS No. 47, many auditors employed some of the model's concepts in practice, albeit they were not explicitly codified and embedded in GAAS. There is, however, no clear record of exactly what practice was in this area prior to SAS No. 47. Generally, it is believed that, while auditors' judgments entered into the audit process, many auditors employed "procedural" approaches that were not fully supported by strict conceptual underpinnings. In other words, audits tended to be conducted using a variety of substantive testing approaches with less reliance on judgments about risk. Testing of internal control, primarily by testing individual transactions, was common and sometimes extensive.

14 Since 1984, auditors have been required to follow SAS No. 47; in other words, they have been required to employ the audit risk model. Notwithstanding this requirement, anecdotal and other evidence indicates that many (but by no means all) audits continued to be performed using substantive testing approaches with little or no attention paid to the results of the risk assessments called for by the model. This phenomenon perhaps is facilitated by the fact that the model permits "defaulting" to an assumption that risks are at a *maximum level*.

15 Over time, however, audit firms began to evaluate both the effectiveness and efficiency of their audits. The sheer volume of transactions processed by client organizations, the fast pace of technological developments affecting client organizations and audit firms alike, and economic constraints on the ability of audit firms to recover rising costs were influential drivers in these evaluations. They led some firms to conclude that many audits were being conducted without sufficient consideration being given to the risk assessment process and that they consequently lacked in both effectiveness and efficiency. Some firms responded by making important changes to their audit methodologies. Furthermore, changes to audit methodologies continue to be made by firms and some of those changes are highly significant.

AUDIT FIRM METHODOLOGIES

16 While all audits of financial statements of publicly held companies are required to comply with GAAS, audit firms are at liberty to design their audit processes or methodologies in whatever manner best suits their needs so long as the processes or methodologies result in audits that comply with GAAS. Historically, audit firms have adapted their processes or methodologies in response to such matters as changes in business or industry conditions, changes in clients' systems or use of technology, and new or changed requirements of GAAS or GAAP.

17 Auditors are guided in many ways by their firms' processes or methodologies – for example, how personnel are assigned to engagements, how they are supervised and their work is reviewed, the way audit working papers are prepared (e.g., by electronic means or otherwise) and the nature and extent of documentation retained in the working papers. For multi-location audits, including those for which work is to be performed outside of the United States, the processes or methodologies guide how that work is carried out and by whom, and how it is reviewed. Included in the processes and methodologies are policies and guidance on matters for which consultation within the audit firm is required or advisable, and on other quality control matters.

18 Audit firms also take into consideration their clients' expectations, such as expectations that the auditor will inform them of matters that might benefit their businesses. Clients' expectations often go well beyond GAAS requirements for performing financial statement audits. Auditors respond to those expectations by providing information or services beyond the financial statement audit, either separately or as an integral part of their audit processes and methodologies.

APPENDIX B – THE AUDIT FIRMS

1 There are approximately 15,000 entities, including about 1,200 international companies, that file financial statements with the SEC.¹ The financial statements included in those filings are audited by a variety of international, national, regional and local audit firms. The differences among the firms in terms of structure and service offerings, client demographics and size of practice usually result in their being stratified into two groups, the eight largest firms and all other firms. Additional information about audit firms is included in Chapter 5 of this report (comparative mix of revenue data) and Appendix D.

2 Substantially all U.S. registrants are audited by member firms of the SEC Practice Section (SECPS). Not all members of the SECPS audit public companies. According to recent AICPA data, the SECPS membership profile by number of SEC clients is as follows:

<u>Number of SEC clients</u>	<u>Number of member firms</u>
0	478
1	352
2 – 4	298
5 –10	104
11-15	19
16-20	9
21-30	11
Over 30	<u>14</u>
Total	<u>1,285</u>

Thus, 65% of the SECPS member firms have only one or no SEC clients; almost 90% have four or less. In addition, approximately 50 U.S. firms that are not SECPS members audit the financial statements of U.S. registrants. Some of those firms are not eligible for SECPS membership because of past violations of the membership requirements.² Most foreign registrants are audited by foreign firms that are not members of the SECPS.³

¹ SEC staff estimates as of March 2000.

² SEC Practice Section, *Annual Report – Year Ended June 30, 1997*.

³ See Chapter 7 for a description of recent changes to SECPS membership requirements for member firms with foreign associated firms that perform audits of foreign registrants. Each SECPS member firm is required to seek the adoption of the changes by any firm outside the United States that is a member of, correspondent with or similarly associated with an international firm or international association of firms with which the SECPS member is associated.

EIGHT LARGEST FIRMS

The Big 5 Firms

3 The five largest audit firms are (in alphabetical order) Arthur Andersen LLP, Deloitte & Touche LLP, Ernst & Young LLP, KPMG LLP and PricewaterhouseCoopers LLP. They are commonly referred to as the “Big 5 firms.” Since their founding over 100 years ago, these firms have become highly regarded as established leaders in the accounting and auditing profession. In 1999, these firms collectively audited approximately 76% of U.S. public registrants⁴ and had U.S. revenues of approximately \$26 billion, of which approximately \$9.5 billion was for accounting and auditing services.⁵

International Presence

4 The Big 5 firms are international accounting, auditing and consulting firms whose U.S. practices are organized as limited liability partnerships. The average size of a Big 5 firm in the United States is approximately 90 offices, 2,000 partners and 24,000 professionals.⁶ Globally, these firms average approximately 100,000 professionals serving clients across 130 countries.⁷

5 The global organization of the Big 5 firms varies. Their structure may range from an affiliation of firms joined by international marketing and cost-sharing agreements without central management to a single integrated firm that is managed internationally. Globalization efforts have focused primarily on common branding and marketing, consistent service delivery, common infrastructure and access to additional capital resources. The majority of the Big 5 firms have established their international presence through international affiliations. Historically, the affiliate structure has presented obstacles in delivering seamless global service to clients and achieving uniform management policies because of the level of autonomy that may remain with the individual affiliates.

6 Increasingly, there is market pressure to be organized as an integrated global firm that can act as one entity, deliver uniform worldwide services and implement consistent business policies. Recently, some of the firms have moved toward complete globalization by combining member firms in certain regional areas, which has strengthened the delivery of global services to clients and assisted in creating and implementing uniform accounting and auditing standards worldwide.

⁴ Data provided by SECPS staff.

⁵ Compiled from information in “Annual Survey of National Accounting Firms – 2000,” *Public Accounting Report*, March 31, 2000.

⁶ Compiled from 1999 firm annual reports submitted to the SECPS.

⁷ Compiled from data on firm websites as of February 2000.

Service Offerings and Structure of Practice

7 The Big 5 firms offer a wide array of services, encompassing:

- Assurance services, including traditional audit, information systems security, internal audit outsourcing and risk assurance services
- Tax services, including corporate and individual planning and compliance and global strategic tax planning
- Consulting services, including strategic change management, process improvement, systems design and implementation, and human resources

8 The increased demand for and competitive pressures to expand these service offerings, differentiate them and identify new markets have led the Big 5 firms to:

- Adopt the term “assurance” services as an umbrella for audit activities and other services historically provided by the audit staff, such as assistance in mergers and acquisitions, as well as newly developed services that are audit related, such as internal audit outsourcing and risk assurance
- Assign the delivery of specialized assurance services, such as transaction-based services (e.g., due diligence and financing advice), to teams of experts in those fields
- Develop new service offerings to address emerging market needs, such as e-business
- Expand the breadth of consulting services to compete with traditional consulting firms
- Expand tax services to include legal services

The expansion of these services has contributed significantly to the Big 5 firms’ annual double-digit revenue growth over the past decade. Three of the Big 5 firms have announced that they have split off, or intend to split off, some or all of their consulting practices from their audit and tax practices, as discussed in Chapter 5.

The Next Three Largest Firms

9 The next three largest firms are (in alphabetical order) BDO Seidman, LLP, Grant Thornton LLP and McGladrey & Pullen, LLP. In 1999, these firms collectively audited approximately 6% of U.S. registrants. The average size of these firms is 47 U.S. offices, 330 partners and 2,200 professionals.⁸ Globally, they average 483 offices across 86 countries.⁹

⁸ Compiled from 1999 firm annual reports submitted to the SECPS.

⁹ Compiled from data on firm websites as of August 2000.

10 BDO Seidman, LLP and Grant Thornton LLP are international accounting and consulting firms organized in the United States as limited liability partnerships. Their global reach is achieved through various international affiliations. In addition, BDO Seidman has formed the BDO Seidman Alliance, which is an alliance of more than 30 independent U.S. firms.

11 McGladrey & Pullen, LLP (McGladrey) is a national accounting firm that is represented internationally through its affiliation with RSM International. McGladrey provides audit and accounting services and certain income tax services to its clients. McGladrey is related to RSM McGladrey, Inc., which offers clients nonattest professional services. McGladrey and RSM McGladrey, Inc. are separate legal entities. McGladrey is wholly owned by its partners, and RSM McGladrey, Inc. is an indirect wholly owned subsidiary of H&R Block, Inc. In August 1999, H&R Block, Inc. acquired the non-attest assets and business of McGladrey and consolidated them with those of other smaller accounting firms in a “roll-up” transaction.

12 Like the Big 5 firms, these firms provide accounting, tax and consulting services, but the services are directed primarily to middle market, entrepreneurial clients. Competitive pressures for firm growth and capital needs and regulators’ concerns for auditor independence have led these firms to focus on many of the same growth strategies as the Big 5 firms.

OTHER FIRMS

13 There are approximately 45,000 local and regional accounting firms in the United States, generally organized as partnerships or sole proprietorships,¹⁰ of which approximately 800 audit SEC registrants and are members of the SECPS.¹¹ Collectively, these SECPS members audit approximately 17% of U.S. registrants.¹² Over 7,200 of the smaller firms¹³ are members of the AICPA’s Partnering for CPA Practice Success, which was founded in 1977 to serve as an advocate for smaller firms within the AICPA and to improve the quality of their services and operations. The smaller firms play a significant role in contributing to the leadership of the profession. They participate extensively in AICPA boards, committees and initiatives such as the CPA Vision Project and CPA Web Trust.¹⁴

International Presence

14 The smaller firms generally have not had a significant international presence as their practices have been focused regionally or locally. However, that is changing as these

¹⁰ Data provided by AICPA staff.

¹¹ See paragraph 2.

¹² SECPS 1997 Annual Report.

¹³ AICPA website, August 2000.

¹⁴ The purpose of the CPA Vision Project is to define a comprehensive and integrated vision of the profession’s future. CPA Web Trust is an example of expanding assurance services beyond their traditional boundaries.

firms increasingly form networks of independently owned firms within the United States and internationally. These domestic and international associations seek to leverage the firms' collective knowledge, obtain client referrals, establish strategic alliances, expand their geographic reach and increase their service offerings. There are now more than 130 associations of accounting firms, including 30 international associations, that together include approximately 1,000 U.S. regional and local firms.¹⁵

15 Generally, association membership requires annual dues to fund the activities of the association and may require correspondent fees for certain referrals and labor sharing. There is no profit sharing or common name among the association members, and common branding is limited generally to references by a firm to its membership in the association on its letterhead or website.

Practice and Structure

16 Alternative structures for small firms have emerged as a result of corporate purchases of their non-attest businesses and roll-up transactions in which the purchasing entity (frequently referred to as a "consolidator") acquires the non-attest assets and employees of small firms. Because state laws generally require that CPAs own at least a majority of audit firms, the audit practices of these firms are retained in partnerships controlled by their former partners. In these structures, several audit firms may be affiliated with, but not owned by, the consolidator, or the firms may be merged into a single audit firm. As a result of these transactions, an operational link is formed between the audit partnership and the new corporate entity performing the non-attest services. Various business arrangements, such as cost sharing and employee leasing, may occur between the two entities.

17 Many industry leaders believe that consolidation in one form or another is the business model of the future for small firms because it provides for expanded services, improved name recognition, higher staff retention and expanded capital resources. Some view consolidators and associations as a means of leveling the playing field between the small firms and the large firms in the middle market arena.

¹⁵ David Albrecht, professor of accounting, Bowling Green State University, Bowling Green, Ohio, as quoted in Richard Glickman, "International Associations," *Journal of Accountancy* (January 2000).

APPENDIX C – CURRENT GOVERNANCE SYSTEM

OVERVIEW AND HISTORICAL PERSPECTIVE

1 Society often grants professions the right to regulate themselves to protect the interests of both their members and the public. The auditing profession has long maintained a voluntary, self-regulatory governance system through the activities of the American Institute of Certified Public Accountants (AICPA)¹ and, in more recent years, the Financial Accounting Standards Board (FASB), Independence Standards Board (ISB), SEC Practice Section (SECPS) and Public Oversight Board (POB). This system has been improved and modified continually as political, social and economic conditions and needs have changed.

2 Although the goals of self-regulation and public regulation are similar – protecting the public interest – and the two systems operate in concert with one another, there are important differences. Robert K. Mautz noted that:

Public regulation is conducted with the full power of the state in support of established requirements. Self-regulation has no equivalent authority. At most, it can exclude noncomplying members from whatever benefits group membership confers or impose whatever sanctions members have voluntarily agreed to accept. Such powers as the ability to subpoena records and witnesses are not available in self-regulation.²

3 In the mid-1970s, reports of U.S. companies paying bribes to foreign officials and several highly publicized corporate bankruptcies resulted in the U.S. Congress looking into the accounting profession. Hearings were held in both the House of Representatives (chaired by John E. Moss) and the Senate (chaired by Lee Metcalf) to investigate these matters and the role of independent auditors. In 1977, the profession created the SEC Practice Section as part of the Division for CPA Firms of the AICPA, which gave rise to unprecedented voluntary self-regulatory initiatives:

- Independent oversight of the SECPS by the POB
- Mandatory peer review
- Mandatory continuing professional education
- Establishment of the Quality Control Inquiry Committee (QCIC) (initially called the Special Investigations Committee)

¹ Including the Auditing Standards Board (ASB) (see Appendix A).

² Robert K. Mautz, “Self-Regulation: Perils and Problems,” *Journal of Accountancy* (May 1983) (initially presented as an address at the AICPA’s tenth national conference on current SEC developments [January 1983]).

These initiatives required SECPS member firms to subject their professional practices to peer review, independent oversight by the POB and scrutiny by the SEC.

4 Initially, membership in the SECPS was voluntary. Membership grew rapidly in the initial three years to include CPA firms that audited approximately 75% of all SEC registrants. There was criticism, however, of the voluntary nature of participation and the fact that non-participating CPA firms that audited SEC registrants numbered in the hundreds. In response, in 1988, the AICPA membership changed its by-laws to mandate that each individual member of the AICPA who provides attest services to an SEC client (as defined in the SECPS membership requirements) be employed by or affiliated with a CPA firm that is an SECPS member.³ Presently, there are approximately 1,300 member firms in the SECPS that collectively audit more than 99% of all U.S.-based SEC registrants.

5 The SECPS created a structure and requirements for its member firms with one end in mind – to protect the public interest by improving the quality of practice by CPA firms before the SEC. Each member firm is required to install a system of quality control to provide reasonable assurance that the firm conforms with professional standards in conducting its accounting and auditing practice. The requirements are flexible enough to allow firms of all sizes (from sole practitioners to international firms) to design and operate systems that are appropriate for their practice. The system of quality control must include elements related to independence, integrity and objectivity; personnel management; acceptance and continuance of clients and engagements; engagement performance; and monitoring.

THE COMPONENTS OF SELF-REGULATION

6 The profession's self-regulatory system complements public regulation. Self-regulation extends beyond public regulation in some areas (discipline, for example), while in other areas, such as standard setting, it largely takes the place of public regulation. The profession's self-regulatory structure includes bodies that set professional standards as well as bodies that conduct the related compliance and disciplinary procedures that apply to CPAs and CPA firms as a result of their voluntary memberships in the AICPA. The standards include technical, ethical and quality control standards, and requirements for continuing professional education. A chart of the current governance structure is included in Table 1 at the end of this appendix.

Public Oversight Board

7 At the time of its formation, the SECPS sought to quiet those who might question the effectiveness of a voluntary self-regulatory model whose cornerstone would be a review by, and among, peers. Although a public regulatory system was already in place, the

³ Non-compliance by an individual AICPA member results in his or her expulsion from the AICPA.

SECPS wanted an independent component that would represent the public interest. This led to the POB.

8 The POB comprises five independent public members – primarily non-accountants with a broad spectrum of business, professional, regulatory and legislative experience – who represent the public interest. The POB nominates and elects its own replacements. The current members are:

- Charles A. Bowsher, Chairman, Comptroller General of the United States and head of the General Accounting Office (1981–1996), Partner of Arthur Andersen & Co. (1971–1981), Assistant Secretary of the Navy—Financial Management (1967–1971) and corporate director
- Donald J. Kirk, Vice Chairman, Financial Accounting Standards Board, member (1973–1977) and Chairman (1978–1986), Partner of Price Waterhouse & Co. (1967–1973), Columbia Business School, Professor (1987–1994), Executive-in-Residence (1995–present) and corporate director
- Melvin R. Laird, Secretary of Defense (1969–1973), Counselor to the President (1973–1974), nine-term member of the U.S. House of Representatives (1953–1969)
- Norman R. Augustine, Chairman and CEO of Martin Marietta Corporation (1987–1995), Chairman and CEO of Lockheed Martin Corporation (1996–1997), Assistant (1973–1975) and Under (1975–1977) Secretary of the Army, Chairman and Principal Officer of the American Red Cross (1992–present) and corporate director
- Paul H. O’Neill, Chairman and CEO of Alcoa (1987–1999) and corporate director

9 The POB has sole discretion in the hiring and replacement of its Executive Director, who is responsible for hiring and supervising the technical and administrative staffs. Dues paid by SECPS member firms support the POB; however, the POB is responsible for determining all aspects of its budget, including compensation levels of the Board members and the staff.

10 The POB’s primary function is to monitor and report on the activities of the SECPS. Its objective is to safeguard, and act as an advocate of, the public interest. Accordingly, the POB meets regularly with standard-setting bodies, public regulators and those responsible for the various SECPS activities.

11 Over the years the POB has expanded its role by identifying and commenting on issues related to the quality of auditing and financial reporting in the United States. In that capacity, the POB has issued reports that include:

- *Scope of Services by CPA Firms* (1979), an analysis of and recommendations regarding non-audit services provided by CPA firms to their SEC audit clients
- *Public Perceptions of Management Advisory Services Performed by CPA Firms for Audit Clients* (1986), a research report prepared by the Survey Division, Audits & Surveys, Inc., which reported the survey results of nine key publics' perceptions of the management advisory services (MAS) issue. The survey results suggested that members of the key publics think that performing certain MAS can impair objectivity and independence and that caution needs to be exercised when CPAs perform any MAS for their audit clients.
- *In the Public Interest* (1993), a special report dealing with issues confronting the accounting profession
- *Strengthening the Professionalism of the Independent Auditor* (1994), by the Advisory Panel on Auditor Independence, chaired by Donald J. Kirk and often referred to as the Kirk Panel Report. The Advisory Panel was formed in response to concerns expressed by the Chief Accountant of the SEC in January 1994 regarding his perceptions of auditors' acquiescence to clients' accounting policies. The recommendations in the report called for auditors to look to the audit committee and the board of directors – the shareholders' representatives – as the audit client, not corporate management.
- *Allies in Protecting Shareholder Interests* (1994), a report to directors, management and auditors that discusses the corporate governance recommendations contained in the Kirk Panel Report

SEC Practice Section

12 The SECPS's activities are carried out by its Executive Committee, Peer Review Committee, QCIC, SEC Regulations Committee, and the Professional Issues Task Force (PITF).

SECPS Executive Committee

13 The SECPS Executive Committee governs the SECPS's activities, which are subject to oversight and public reporting by the POB. The responsibilities of the SECPS Executive Committee include:

- Establishing the SECPS membership requirements
- Establishing budgets and dues requirements to fund the SECPS's activities
- Determining sanctions to be imposed on member firms for failing to comply with the SECPS membership requirements
- Appointing persons to serve on such committees and task forces as are

necessary to carry out the SECPS Executive Committee's functions

- Consulting from time to time with the POB

14 Well-defined membership requirements are critical to the SECPS's overall success. The SECPS adopted numerous membership requirements at the outset, and has continued to amend and add to them as times and circumstances have changed. The principal membership requirements include:

- Adhering to quality control standards established by the AICPA
- Submitting to a peer review of the firm's accounting and auditing practice every three years
- Ensuring that all professionals within the firm participate in specified amounts of continuing professional education
- Assigning an audit partner to be in charge of each SEC engagement up to a maximum of seven years
- Assigning a second partner to perform a preissuance concurring review of the auditor's report and financial statements of each SEC client
- Establishing independence policies covering relationships between (a) the member firm, its benefit plans and its professionals (and the close relatives of such professionals) and (b) "restricted entities" of the firm (i.e., all audit clients that are SEC registrants and certain entities related to such clients)
- Maintaining an independence database that includes, at a minimum, (a) all restricted entities and (b) for firms with at least 7,500 professionals, partners' and managers' investment holdings, so the two can be matched on a timely basis
- Designating a senior-level partner to be responsible for timely updates to the independence database and for overseeing the adequate functioning of the firm's independence policies and consultation process
- Seeking adoption of policies and procedures by a firm's international organizations or individual foreign associated firms whereby (a) a "filing reviewer" (a person or persons knowledgeable in accounting, auditing and independence standards generally accepted in the United States) would perform certain limited review procedures prior to the submission of certain SEC filings that include or incorporate the foreign associated firm's audit report, and (b) a sample of SEC audit engagements would be reviewed as part of the annual inspection program of the international organization or the individual foreign associated firms
- Reporting annually the names and countries of the foreign associated firms that have represented that they have established such policies and procedures
- Filing with the SECPS each year an annual report containing certain demographic and statistical data related to the firm's attest, tax and MAS services to SEC clients
- Reporting annually to the audit committee or board of directors of each SEC client on the total fees received from the client for MAS and a description of the services

- Reporting to QCIC within 30 days of being served with any litigation or regulatory proceeding relating to alleged audit deficiencies in the audit of an SEC client

Peer Review Committee

15 CPA firms are required to create a system of quality control, in accordance with promulgated standards, that is appropriate for their size, the nature and complexity of their practice, and other factors. The peer review process was established to evaluate whether:

- A firm's quality control system for its accounting and auditing practice appropriately addresses each element of quality control
- The quality control policies and procedures are adequately documented and communicated to professional personnel
- Personnel are complying with the policies and procedures
- The firm is complying with the SECPS membership requirements

16 Independent peer reviewers, that is, other audit firms, examine each firm's quality control system every three years. The peer reviewers examine both the design of the system and compliance with it, including a review of internal firm documents and selected audit reports and working papers. At the completion of the peer review, the peer reviewers issue a report on the effectiveness of the design of and compliance with the system. The report, similar to that rendered at the completion of an audit, may be unmodified, modified or adverse. The report also may refer to a separate letter of comments that enumerates deficiencies in the system of quality control that were noted during the peer review. (When the report is unmodified, it states that none of the deficiencies are of such significance as to result in a modified report.) The reviewed firm is required to submit a letter of response to the Peer Review Committee (PRC) describing the actions taken, or to be taken, by the firm to correct the deficiencies.

17 The peer review report and, if applicable, the letter of comments and letter of response (collectively, the peer review reports), together with the peer review working papers, are submitted to the POB staff or the SECPS staff for review. The POB staff performs an in-depth review of the peer review working papers and related peer review reports for those firms, including all of the largest firms, that meet its risk-based criteria. The POB staff provides oversight on all other peer reviews. The SECPS staff reviews the peer review working papers and related reports for those peer reviews that the POB staff does not review. Collectively, the SECPS and POB staffs then present the reports to the PRC (comprising representatives from 18 member firms) for acceptance. On acceptance, the peer review reports are placed in a public file at the AICPA.

18 When necessary, the PRC imposes corrective measures on member firms to make certain that quality control deficiencies are corrected. Those corrective measures and the

number of times they were imposed during the SECPS's fiscal year ended June 30, 1999, and since the inception of the peer review process are as follows⁴:

Action	<u>Year Ended June 30, 1999</u>	<u>Since Inception</u>
Accelerated peer review	1	54
Employment of an outside consultant to perform preissuance reviews of financial statements or other specified procedures	11	110
Oversight by the peer reviewers or a PRC member to monitor progress made by the firm in implementing corrective actions	11	220
Oversight of the firm's internal monitoring program	32	402
Changes made to the firm's quality control document or other guidance materials	1	44
Continuing professional education in specified areas	4	62*

* Since July 1, 1988; data for prior years are no longer available.

19 The POB oversees the entire peer review process, including reviewing the qualifications of peer reviewers. Further, under the provisions of an access agreement between the POB and the Office of the Chief Accountant (OCA) of the SEC, the peer review working papers and related reports (masked to protect the confidentiality of individual registrants) are made available for review and oversight by the OCA staff.

Quality Control Inquiry Committee

20 Shortly after the SECPS instituted the peer review process, its member firms and the SEC sought a means to address issues of alleged audit failures that occurred during the three-year period between a firm's peer reviews. The result was the Special Investigations Committee, later renamed QCIC, which consists of approximately 12 representatives of member firms, most of whom are retired.

21 Member firms are required to report to QCIC, within 30 days of being served, all matters of alleged audit failures involving SEC clients arising from litigation or regulatory investigations, including criminal indictments. The QCIC process begins almost immediately after a matter is reported; it is not deferred while litigation or regulatory proceedings are in process. The allegations are investigated by QCIC members and staff to determine whether there are deficiencies in the reporting firm's system of quality control, its compliance with the system, or the professional standards relevant to the matters in the case. QCIC does not make any determinations concerning the guilt, innocence or liability of the reporting firm.

⁴ Public Oversight Board, *Annual Report 1999*.

22 The activities of QCIC take place in four distinct phases. Each case added to its agenda might require QCIC to employ the procedures in one or more phases. The phases and the related procedures are as follows:

Phase No. 1 – Analysis of allegations

23 Read the complaint against the firm, relevant financial statements and any other publicly available relevant materials. After evaluating the information, proceed to Phase No. 2 unless the case file can be closed because, after analysis, QCIC considers the complaint to be frivolous. A frivolous complaint is characterized by, among other things:

- Allegations that do not relate to a period in which the auditor was associated with the entity's financial statements
- Allegations that are so general in nature that they do not raise serious implications concerning the adequacy of the firm's system of quality control or its compliance with that system
- Allegations that ignore relevant and adequate disclosures made in the financial statements or information contained in the auditor's report
- Allegations that do not relate to matters that are encompassed by existing generally accepted accounting principles (GAAP) or generally accepted auditing standards (GAAS), or that clearly misstate their requirements

Phase No. 2 – General inquiries

24 Discuss the issues addressed by the allegations that have quality control implications with representatives of the firm. Based on those discussions, proceed to Phase No. 3 unless the case file can be closed because one or more of the following conditions exist:

- The relevant aspects of the firm's system of quality control are considered adequate based on QCIC's review of the firm's relevant guidance materials and established firm auditing or quality control policies and procedures
- The complaint stems from a business failure, not an audit failure
- Nothing more than minor changes in quality control were necessary, and the firm has taken appropriate corrective measures and has satisfied QCIC that those changes are effective

Phase No. 3 – In-depth inquiries

25 Discuss with firm personnel who are familiar with the subject engagement the quality control policies and procedures and compliance with them; review firm technical manuals, guidance materials and inspection reports; or read certain audit documentation having a bearing on the issues addressed by the allegations. Based on those procedures, proceed to Phase No. 4 unless the case file can be closed because the responses to QCIC's inquiries provide a reasonable basis to conclude that the firm's quality control policies and procedures are adequate and were complied with.

Phase No. 4 – Special review

26 A special review is ordered whenever QCIC, based on its evaluation of responses to in-depth inquiries, is not satisfied that the firm's quality control system provides the firm with reasonable assurance of performing audit engagements in compliance with professional standards, whether for the firm as a whole, an office or a specific industry. The scope of a special review is directly related to the extent of the possible quality control deficiencies and any corrective actions that may be needed.

27 From July 1, 1981, through June 30, 2000, QCIC has opened 866 cases (see Table 2 to this appendix).

28 Before 1998, the AICPA Ethics Division would open a case file on the AICPA members on the engagement concurrent with QCIC opening a case file. The Ethics Division, as a matter of fairness to an AICPA member and at the member's request, would defer its investigation until the litigation or regulatory proceeding had been completed, which often was many years after the allegation had been made. Even when the QCIC investigation resulted in a determination that the allegation was frivolous, the Ethics Division would expend considerable time and resources (albeit many years later) to reach a similar conclusion.

29 In 1998, in an attempt to eliminate this waste of time and resources, the SECPS Executive Committee and the Professional Ethics Executive Committee (PEEC) entered into a Memorandum of Understanding (MOU) whereby QCIC would assign a rating to each case at the conclusion of its investigation, ranging from a "1" to a "4." The ratings and related recommendations are:

1. QCIC deems the case to be frivolous and recommends that no actions be taken by the PEEC with respect to the engagement personnel.
2. QCIC determines that no engagement personnel issues of significance are involved in the case and recommends that no actions be taken by the PEEC with respect to the engagement personnel.
3. QCIC believes that there may be engagement personnel issues of significance, and recommends that the PEEC determine whether or not to open an investigation of certain engagement personnel.
4. QCIC recommends that the PEEC open an investigation of certain engagement personnel.

30 Since the inception of the MOU, which was made retroactive to those cases closed by QCIC at its December 1997 meeting, a total of 125 cases have been rated, the results of which are:

<u>Rating</u>	<u>No. of cases</u>
1	12
2	64
3	38
4	11

31 As of August 2000, the PEEC has reviewed 36 of the cases rated as “3” and opened a case file on 28 of those matters. Noteworthy is the fact that the PEEC did not open a case file on 84 of the 125 cases, which allows it to devote additional time and resources to those cases that merit its scrutiny. In addition, QCIC has referred 25 current or former client personnel who are members of the AICPA to the PEEC.

32 The following table presents QCIC’s actions related to member firms, professional standards and individuals for the SECPS fiscal year ended June 30, 1999, and since the inception of QCIC⁵:

	<u>Year Ended June 30, 1999</u>	<u>Since Inception</u>
Actions related to firms		
Either a special review was made, the firm’s regularly scheduled peer review was expanded or other relevant work was inspected	2	72
The firm took appropriate corrective measures that were responsive to the implications of the specific case	6	133
Actions related to standards⁶		
Appropriate AICPA technical bodies were asked to consider the need for changes in, or guidance on, professional standards	3	49
PITF was asked to consider the issuance of a Practice Alert	2	23
Actions related to individuals		
The case was referred to the AICPA Professional Ethics Division with a recommendation for investigation into the work of specific individuals	14	46

⁵ Public Oversight Board, *Annual Report 1999*.

⁶ During its analysis of cases, QCIC is cognizant of the need to identify matters for which it believes the profession would benefit from additional or more specific standards or guidance. It refers these matters to the appropriate standard setters or the PITF for inclusion in a Practice Alert.

33 The POB oversees the QCIC process through its participation in all aspects of QCIC's analysis, investigation and closing of each matter. Further, the SEC staff reviews the Closed Case Summary prepared by the QCIC staff, together with the POB's oversight files for each matter.

SEC Regulations Committee

34 The SEC Regulations Committee acts as the primary liaison between the profession and the SEC on technical matters relating to SEC rules and regulations. It provides input to the SEC on accounting and auditing matters, as well as relevant guidance to AICPA members.

35 The SECPS Regulations Committee consists of representatives from SECPS member firms, academia and industry.

Professional Issues Task Force

36 The PITF was created by the SECPS Executive Committee to accumulate and consider practice issues that present potential audit concerns for practitioners from numerous sources, including QCIC, the PRC and the POB.

37 The PITF disseminates its information through non-authoritative Practice Alerts, which are published in the version of *The CPA Letter* that is distributed to AICPA members in public accounting firms. The Practice Alerts also are available on the AICPA's website. The PITF also refers matters that may require a reconsideration or reinterpretation of existing standards to appropriate standard-setting bodies.

38 The PITF consists of representatives from a number of SECPS committees, the ASB, PEEC and the legal departments of audit firms.

Firm Policies and Procedures

39 Audit firms establish, maintain and enforce firm-wide quality control policies and procedures. These measures are designed to provide each firm with reasonable assurance that it complies with professional standards, maintains its technical capabilities, applies the appropriate expertise on all audits and meets the SECPS membership requirements. Although invisible to the public, internal monitoring of audit quality is considered by many to be the most pervasive and productive of all types of regulation. The principal components of internal monitoring include periodic inspection procedures, determination of any corrective actions to be taken and improvements to be made in the quality control system, vigorous internal challenges regarding client acceptance and continuance decisions, independent preissuance reviews of audit engagements, and continuous updating of guidance and training materials and their dissemination to professional personnel. Enlightened self-interest has led firms to emphasize the importance of quality

control and to discipline professionals who depart significantly from firm policies and professional standards.

Standard-Setting Bodies

40 Professional standards form the basis for measuring performance. The standard-setting bodies in the accounting profession include:

Financial Accounting Standards Board

41 The federal securities laws give the SEC statutory authority for establishing accounting standards. In meeting this statutory responsibility, the SEC historically has looked to the standard-setting bodies designated by the profession to provide leadership in establishing accounting principles. Since 1973, that body has been the FASB.

42 The FASB, as part of the Financial Accounting Foundation (FAF), is a not-for-profit organization supported by contributions from accounting firms, corporations and other entities that are interested in accounting issues. The FASB consists of seven full-time members who are selected and approved by the FAF; the FASB establishes its agenda through discussions with parties interested in financial accounting.⁷ The FASB's deliberations are open to the public and its standards are subject to public exposure prior to issuance. The FASB maintains a dialogue with the SEC regarding its deliberations and activities.

43 In order to provide timely guidance to financial statement preparers, auditors and users on emerging issues that affect financial reporting, the FASB established the Emerging Issues Task Force (EITF). The EITF identifies emerging accounting issues and publishes its "consensus" in authoritative releases. The short time frame in which the EITF is expected to respond to the need for guidance does not permit preissuance public exposure of its pronouncements. The Chief Accountant of the SEC, who has the right to the floor, attends the EITF meetings as "the SEC Observer."

44 The Accounting Standards Executive Committee (AcSEC) of the AICPA promulgates GAAP on certain industry issues and other matters (e.g., software revenue recognition), under the FASB's oversight. Most AcSEC pronouncements are exposed for comment prior to issuance.

Auditing Standards Board

45 After the highly publicized McKesson-Robbins audit failure in 1939, the AICPA established the predecessor committee to the ASB to promulgate GAAS. The ASB is

⁷ The FAF established the Financial Accounting Standards Advisory Council (FASAC) to advise the FASB on issues related to projects on the FASB's agenda, possible new agenda items, project priorities, procedural matters that may require the attention of the FASB, and other matters as requested by the FASB chairman.

funded by the AICPA through members' dues. Its pronouncements, which include quality control standards as well as GAAS, are subject to public exposure and comment. Like the FASB, the ASB maintains a dialogue with the SEC regarding its activities and deliberations. The ASB's pronouncements are applicable to audits of all entities, not just to audits of public companies; however, certain Statements on Auditing Standards (SASs) are applicable primarily to public company engagements (e.g., SAS No. 71, *Interim Financial Information*).

46 The ASB consists of 15 members, with representatives from audit firms, academia and government (either state or federal government entities). The AICPA Board of Directors approves the membership of the ASB.

AICPA Ethics Division

47 After the creation of the SEC, the AICPA adopted certain auditor independence rules that were necessitated by the SEC's requirement for audits by independent accountants. Subsequently, the AICPA formed its Ethics Division, which, through the PEEC, is responsible for changes to and determining compliance with the profession's Code of Professional Conduct. Unlike the SEC, the Ethics Division does not have subpoena power and its disciplinary authority extends only to individual AICPA members. As previously noted, its disciplinary process is deferred while litigation or regulatory proceedings are in process.

Independence Standards Board

48 The ISB was established in 1997 by the SEC and the AICPA for the purpose of assuming responsibility from the SEC for establishing standards for auditor independence with respect to audits of public companies. The ISB is funded by the SECPS, but it is an autonomous body with responsibility for hiring and supervising its staff, establishing its budget and, with input from the SEC, determining its agenda.

49 The ISB consists of eight members, of whom four are public members and four are from the accounting profession. Three of the accounting profession members, who are nominated by the SECPS Executive Committee, are representatives of SECPS member firms, and the fourth is the President of the AICPA or his or her designee. The public members are responsible for nominating their successors. The SECPS-nominated ISB members must be approved by the AICPA Board of Directors.

50 In accordance with SEC Financial Reporting Release No. 50 issued in December 1997, standards issued by the ISB will be deemed by the SEC to have "substantial authority" regarding matters of auditor independence with respect to audits of public companies; however, ISB standards that are less restrictive than existing SEC or AICPA rules will not be effective until the SEC or the AICPA amends or revokes its rules. (The

PEEC retains responsibility for all other matters contained in the Code of Professional Conduct, including the rules relating to independence for audits of all other entities.)⁸

⁸ In May 2000, the PEEC stated that it would view any pronouncement issued by the ISB as authoritative for *any* engagement requiring independence unless and until the PEEC announces that it will not view that pronouncement as authoritative. Accordingly, if an AICPA independence standard is more restrictive, in whole or in part, than an ISB pronouncement, the PEEC will not consider a member's independence to be impaired as a result of his or her non-compliance with the more restrictive AICPA standard until members are given notice of the PEEC's rejection of the ISB's less restrictive pronouncement.

CURRENT GOVERNANCE STRUCTURE

TABLE 1

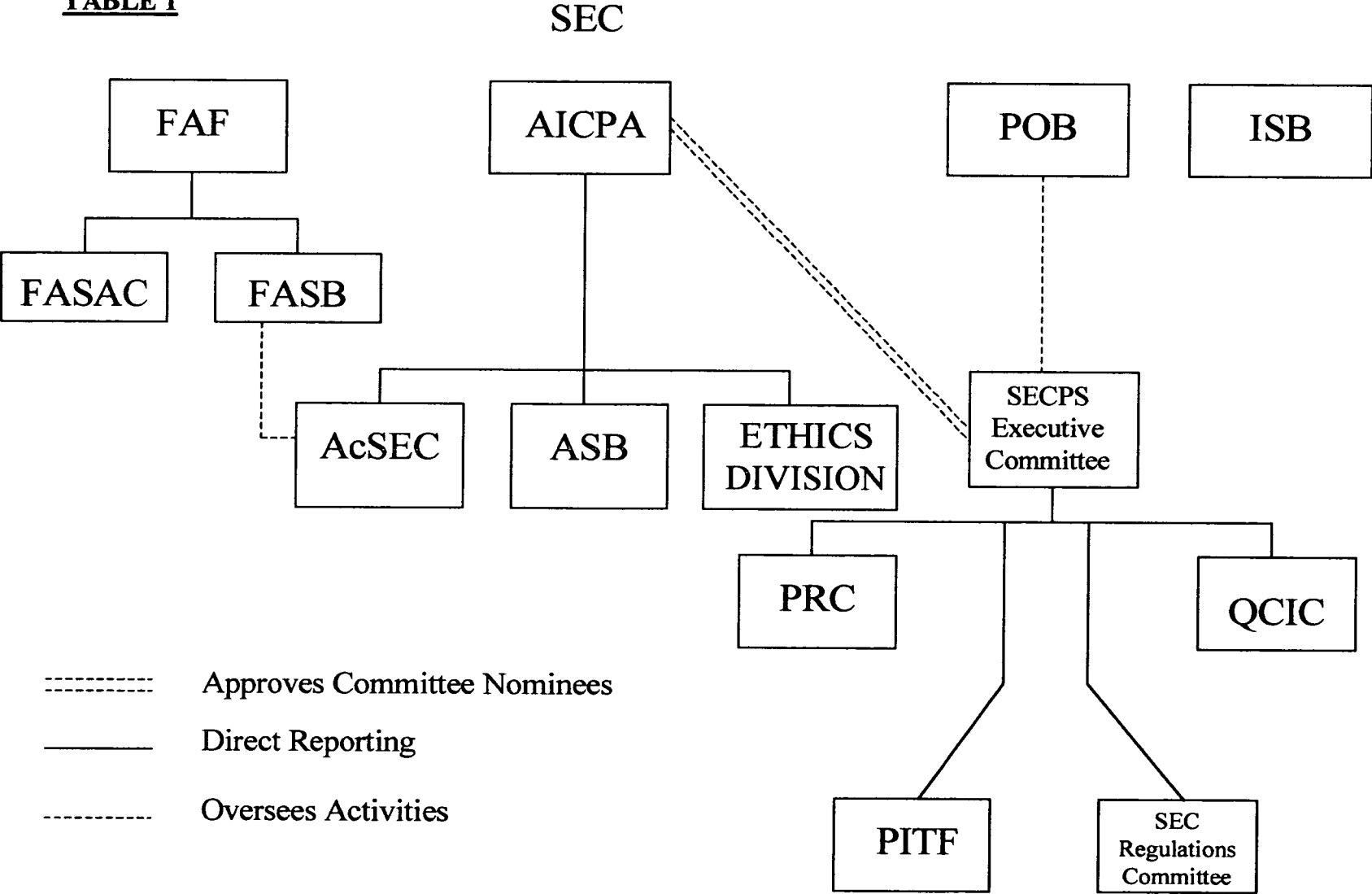


TABLE 2

**Quality Control Inquiry Committee
Number of Cases Reported to QCIC by Year**

Year Ended June 30,	Number of Cases
1982	20
1983	34
1984	27
1985	47
1986	44
1987	44
1988	42
1989	53
1990	56
1991	44
1992	55
1993	59
1994	61
1995	51
1996	33
1997	37
1998	53
1999	48
2000	58
Total	866

APPENDIX D – PRIOR CONSIDERATIONS OF NON-AUDIT SERVICES

1 In its 1957 annual report, the SEC voiced one of the earliest concerns about the breadth of services that auditors provide and whether an auditor could become so closely identified with the client that the auditor would make decisions that should be made by management. In 1959, the SEC's Chief Accountant commented on the possibility of an auditor's becoming so deeply involved in performing managerial services for a client that the auditor would lose the objectivity needed for an audit.¹

2 In 1961, two educators studied non-audit services and concluded that management and tax services tended to cloud the appearance of independence.² They recommended that the audit function be sharply separated from other services provided by a firm. The AICPA's Committee on Professional Ethics issued Opinion No. 12 in 1963, reasserting a 1947 statement by AICPA Council that independence is an attitude of mind. However, the committee recognized that maintaining public confidence required avoiding relationships that might have the *appearance* of a conflict of interest. Opinion No. 12 added that there is no ethical prohibition against a CPA's performing management advisory services (MAS) for an audit client "so long as he does not make management decisions or take positions which might impair objectivity."

3 Opinion No. 12 was followed by a spate of articles and studies on whether auditors can appropriately perform MAS for audit clients.³ Most expressed concerns about the appearance of a conflict. In an address to the AICPA at its 1966 annual meeting, the chairman of the SEC chided the profession over certain types of non-audit services – such as executive recruitment – that he believed raised independence questions.⁴ (Following the Metcalf Subcommittee report in 1977,⁵ the SECPS adopted a rule prohibiting members from providing executive recruitment services to SEC clients.) At the same time, the chairman sought to distinguish "management services" related to financial processes or to information and control systems, which he felt raised no serious threat to independence, from other types of services.

4 In 1966, an AICPA committee began a study of auditors' scope of services and issued its report in 1969.⁶ The committee found no evidence that non-audit services impair

¹ Andrew Barr, *Accounting – Changing Patterns: The Impact of Regulatory Agencies*, address presented in Chicago, November 11, 1959.

² R. Mautz and H. Sharaf, *The Philosophy of Auditing* (American Accounting Association, 1961).

³ For example, A. Schulte, "Compatibility of Management Consulting and Auditing," *Accounting Review* (July 1965); A. Brilloff, "Old Myths and New Realities in Accountancy," *Accounting Review* (July 1966); and J. Carey and W. Doherty, "The Concept of Independence – Review and Restatement," *Journal of Accountancy* (January 1966).

⁴ Manuel F. Cohen, address before AICPA annual meeting, October 5, 1966.

⁵ Subcommittee on Reports, Accounting and Management, Committee on Government Affairs, United States Senate, 95th Congress, 1st Session, *Improving the Accountability of Publicly Owned Corporations and Their Auditors* (Committee Print 1977) (Senate Report).

⁶ AICPA Ad Hoc Committee on Independence, "Final Report," *Journal of Accountancy* (December 1969).

independence *in fact*, but found that some users believed that such services created an *appearance* of lack of independence.

5 There have been a variety of studies and investigations since then. In 1974, the AICPA formed an independent commission (the Cohen Commission) to study several aspects of the accounting profession and published its findings in 1978.⁷ The Cohen Commission recommended, among other things, that the board of directors (or its audit committee) consider all services provided to the company by the auditor, and that the auditor fully inform the board of all such services and their relationship, or lack thereof, to the audit function. That same year, the SECPS adopted that disclosure recommendation as a membership requirement.

6 Shortly after the Cohen Commission was formed, the United States Senate, through the Subcommittee on Reports, Accounting and Management (Metcalf Subcommittee) of the Committee on Governmental Operations, launched a broad-scale inquiry of the accounting profession, including a review of the nature of services furnished by accounting firms.⁸ The resulting staff report (*The Accounting Establishment*), published in 1977, generally concluded that MAS furnished to audit clients created a conflict of interest. After holding hearings on the staff report, the Metcalf Subcommittee concluded that the only MAS it believed appropriate to provide to public audit clients were “certain computer and systems analyses...necessary for improving internal control procedures of corporations.”⁹ The Metcalf Subcommittee also concluded that certain types of services, such as executive recruitment, marketing analysis, plant layout, product analysis and actuarial services, should not be provided to audit clients.

7 The profession reacted promptly to the Metcalf and Moss subcommittee reports by undertaking a new program of self-regulation, including forming the SECPS, introducing required peer reviews and establishing the Public Oversight Board to oversee the SECPS and peer reviews. The SECPS adopted criteria for scope of services and specified that an auditor may not provide the following services to a public audit client: psychological testing, public opinion polls, merger and acquisition assistance for a finder’s fee, executive recruitment, and actuarial services to insurance companies.

8 Over the years the SECPS has instituted several disclosure requirements related to non-audit services. As noted above, SECPS members must report annually to the audit committee of each SEC client the amounts and nature of MAS rendered. Also, each member’s annual report to the SECPS must include MAS fee data for SEC clients, indicating the number of clients by ranges of such fees as a percentage of audit fees (i.e., the number of clients for which MAS fees were 0% of audit fees, 1-25% of audit fees, 26-50%, 51-100%, and over 100%).

⁷ Commission on Auditors’ Responsibilities, *Report, Conclusions, and Recommendations* (1978).

⁸ Although not focused on non-audit services, in 1978 a House subcommittee (the Moss Subcommittee) also looked into the role of the SEC in establishing accounting principles and overseeing the profession.

⁹ Senate Report (see note 5).

9 Further, Standard No. 1 of the Independence Standards Board (ISB), issued in January 1999, requires auditors (1) to disclose, annually in writing, all relationships between the auditor and the audit client that may reasonably be thought to bear on independence and (2) to confirm their independence. The auditor also must meet with the audit committee to discuss the auditor's independence.¹⁰ The SEC issued a complementary rule in December 1999 that, among other things, requires that proxy statements include reports by audit committees that state whether the committee has received the disclosures required by Standard No. 1 and discussed the auditors' independence with them.¹¹

10 In 1978, the SEC adopted requirements that certain disclosures related to non-audit services be made in the annual proxy statements of public companies.¹² The disclosures included the percentage relationship of fees for all non-audit services to the audit fee, the percentage relationship of the fee for each non-audit service to the audit fee (describing the service if more than 3%), and whether the audit committee or board had approved the services and considered the possible effects on independence. The SEC described the disclosure requirements as an interim step and stated it would not propose any rules limiting scope of services but would await the conclusions of a study by the POB.

11 The POB concluded an extensive study on the issue in 1979.¹³ The POB studied the history of concerns over scope of services and held public hearings, noting that with one exception there were few uniform views. The exception was that almost all agreed that providing MAS was perceived by some persons as creating a situation in which an auditor's independence is impaired. In its report, the POB reviewed the concerns but also balanced them with the many benefits that appeared to accrue from MAS, even citing a comment letter from a former Chief Accountant of the SEC.¹⁴ The former Chief Accountant related some of his own positive experiences, including those as a staff accountant, to illustrate the benefits that he believed MAS brought to the audit process.

12 The POB found it difficult to assess the effects of MAS on independence:

From the voluminous record before the Board, it is apparent that documented evidence of MAS abuses or impairment of independence through the use of MAS is virtually nonexistent.^a Many concerned persons point to a feeling that "it doesn't look right" or a speculation that some services "might" or "could" impair independence, but no one can counter the demonstrated benefits of MAS with some proof that specific practices lead to actual impairment....

¹⁰ In Practice Alert 99-1, *Independence Discussions with Audit Committees*, the SECPS issued guidance designed to assist firms in evaluating and enhancing their policies and procedures for identifying and communicating to audit committees those judgmental matters that may reasonably be thought to bear on the auditor's independence.

¹¹ *Audit Committee Disclosure* (Release No. 34-42266), December 22, 1999.

¹² *Disclosure of Relationships with Independent Public Accountants* (Accounting Series Release [ASR] No. 250, June 29, 1978).

¹³ *Public Oversight Board Report – Scope of Services by CPA Firms* (AICPA, 1979).

¹⁴ Letter from John C. Burton, p. 17 of POB scope of services report (see note 13).

...[T]he absence of any known cases, while comforting, does not serve to prove conclusively that independence has not been, or will not be, impaired due to the furnishing of MAS to audit clients.

...[T]he problem ... is not so much lack of independence in fact as the appearance of lack of independence.¹⁵

^a Specific evidence of loss of independence through MAS, a so-called smoking gun, is not likely to be available even if there is such a loss.

13 The POB concluded that no rules should be imposed to prohibit specific services. In light of the disclosure requirements of ASR No. 250 and the SECPS membership rules, the POB believed it better to rely on public disclosure, supplemented by the admonition to auditors to exercise restraint and judgment before venturing into new MAS areas. The POB also concluded that:

There are many potential benefits to be realized by permitting auditors to perform MAS for audit clients that should not be denied to such clients without a strong showing of actual or potential detriment....

[M]andatory limitations on scope of services should be predicated only on the determination that certain services, or the role of the firm performing certain services, will impair a member's independence in rendering an opinion on the fairness of a client's financial statements or present a strong likelihood of doing so.¹⁶

14 In ASR No. 264 the SEC responded to the POB's report, stating that the report "did not adequately sensitize the profession and its clients to the potential effects on the independence of accountants of performance of non-audit services for audit clients," and invited comments on factors the Commission identified as important to an evaluation of whether non-audit services could impair independence.¹⁷ In 1981, the SEC rescinded ASR No. 264,¹⁸ followed almost immediately by the SECPS's adopting the aforementioned requirement for member firms to disclose the extent of MAS fees and activity in their annual reports to the SECPS. The SEC repealed ASR No. 250 in 1982, citing the new SECPS disclosure requirements and having concluded that the disclosure required by ASR No. 250 "was not generally of sufficient utility to investors to justify continuation."¹⁹

15 In 1986, the POB, having noticed that non-audit services had continued to proliferate despite its admonition that the firms exercise self-restraint and judgment before venturing into new areas of MAS, commissioned a survey of attitudes of various groups toward

¹⁵ POB scope of services report, pp. 33-36 (see note 13).

¹⁶ POB scope of services report, pp. 4-5 (see note 13).

¹⁷ *Scope of Services by Independent Accountants* (ASR No. 264), June 14, 1979.

¹⁸ *Relationships Between Registrants and Independent Accountants* (ASR No. 296), August 20, 1981.

¹⁹ *Relationships Between Registrants and Independent Accountants* (ASR No. 304), January 28, 1982.

non-audit services and independence.²⁰ The POB issued the survey without comment, but reaffirmed that it knew of no instance in which it could be demonstrated that MAS had interfered with auditor independence. The survey results indicated continued concerns that MAS could impair auditor objectivity and independence.

16 Shortly thereafter, the Treadway Commission concluded that the audit committee should oversee management's judgments relating to the independence of accountants by reviewing management's plans for engaging its auditors to perform MAS, considering both the types of services that might be rendered and the projected fees.²¹

17 In March 1994, in response to a Congressional request, the Office of the Chief Accountant (OCA) of the SEC reexamined the existing independence rules and considered whether any changes were needed. The OCA acknowledged the continuing increase of non-audit service offerings by firms and undertook to continue to be alert to the development of problems of auditor independence, but concluded that:

... the extensive systems of independence requirements issued by the Commission and the AICPA, coupled with the Commission's active enforcement program, provide to investors reasonable safeguards against loss due to the conduct of audits by accountants that lack independence from their audit clients. The enactment of detailed legislation or the promulgation of additional rules is not necessary.²²

18 The POB continued to analyze "extended audit services" such as internal audit outsourcing and to monitor the firms' expansion of non-audit services. The POB had concluded that extended audit services need not impair independence if they were properly and carefully structured. The POB suggested that the profession consider whether the Code of Professional Conduct provides an adequate framework and guidance for addressing in a timely manner the implications of new service lines, and organizational structures to provide them, on the traditional concepts of independence.²³

19 In response, the AICPA has issued or revised several ethics interpretations and ethics rulings, including:

- Interpretation 101-3, *Performance of Other Services* – lists many activities that would be considered to impair independence
- Interpretation 101-13, *Extended Audit Services* – discusses circumstances in which internal audit outsourcing and similar services would or would not

²⁰ *Public Perceptions of Management Advisory Services Performed by CPA Firms for Audit Clients*, a research report prepared for the POB by Survey Division, Audits & Surveys, Inc., November 1986.

²¹ *Report of the National Commission on Fraudulent Financial Reporting*, October 1987.

²² SEC, *Staff Report on Auditor Independence*, March 1994.

²³ POB, *Annual Report 1994-1995*. A task force of the SECPS Executive Committee studied the issue of non-audit services. Although no report was issued, its findings were submitted to the then newly formed Independence Standards Board.

impair independence

- Interpretation 101-14, *The Effect of Alternative Practice Structures on the Applicability of Independence Rules* – discusses the extent to which independence rules apply to certain persons outside the “traditional” auditing firm
- Interpretation 102-2, *Conflicts of Interest* – offers guidance when a conflict occurs and on activities that should cause a CPA to consider whether others could view the relationship as impairing objectivity
- Interpretation 102-6, *Professional Services Involving Client Advocacy* – discusses tax, consulting or other engagements that involve acting as an advocate for the client

20 In a 1996 report to Congress,²⁴ the GAO stated that it believed that measures that would limit auditor services are outweighed by the value of traditional consulting services, but added that concerns over independence would grow as firms moved to provide new services that go beyond traditional services. The GAO also urged the profession to be attentive to independence concerns in considering new services.

21 Since then the shifting mix of practice has been a continuing source of concern and has been noted frequently by the SEC. The Chief Accountant of the SEC recently asserted, “These firms no longer advertise themselves as auditing firms, but as one-stop financial services firms that offer a full range of services.”²⁵

22 Recently, the success of the firms’ consulting practices, the explosive growth in technology, and regulators’ concerns over auditor independence have converged and resulted in the Big 5 firms exploring new business strategies for the future. These strategies, which have attracted attention from the regulators with respect to the issue of auditor independence, include:

- Restructuring and separating consulting practices from accounting and tax services
- Fully or partially divesting the restructured practices
- Planning public offerings of the consulting practices to obtain capital

²⁴ United States General Accounting Office Report to the Ranking Minority Member, Committee on Commerce, House of Representatives, *The Accounting Profession – Major Issues: Progress and Concerns*, September 1996.

²⁵ Lynn E. Turner, *Shifting Paradigms in Self-Regulation*, address to the Securities Regulation Institute, January 27, 2000.

23 Some other firms have sold their non-attest practices to other financial services firms and have a variety of alliances with those firms (see Appendix B).

24 The agenda of the Independence Standards Board includes alternative practice structures, as well as appraisal and valuation services, outsourcing engagements and legal services for public audit clients. (Currently, there are certain independence restrictions on the performance by audit firms of legal services for SEC audit clients.) In July 2000, the ISB indicated that it would defer action regarding non-audit services pending the outcome of the SEC's rule-making proposals on independence (see Chapter 5).

APPENDIX E – QUASI PEER REVIEW PROCESS

1 The Panel's primary purpose was to examine whether the audit processes of the large firm members of the SECPS adequately serve and protect the interests of investors. The major element in this examination was the Quasi Peer Review (QPR) process. The QPR process was designed to make a comprehensive review of public company audits performed by the eight largest firms, to evaluate the way independent audits are performed and to assess the effects of recent trends in auditing on the public interest. The QPR process, which occurred during the summer and fall of 1999, gathered empirical data on the quality of a selected sample of SEC audit engagements with 1998 and 1999 year ends. In considering the effectiveness of the audits, the QPR:

- Evaluated the quality of work performed in specific key areas, including risk assessments, reviews of controls, and documentation
- Assessed whether the individuals who performed and reviewed the work had the necessary knowledge, skills and experience
- Determined whether the work was performed and reviewed on a timely basis
- Considered the adequacy of existing professional standards

Recommendations for improving audit-effectiveness were developed from the Panel's QPR findings.

QPR COMPARED WITH SECPS PEER REVIEW

2 While there were numerous similarities between the QPRs and SECPS peer reviews, there also were numerous differences. The differences included:

- In-depth interviews in the QPRs of engagement personnel at all levels
- Focusing the QPRs on specific identified areas, such as the risk assessments, the linkage of the risk assessments to tests of controls and substantive tests, and whether the people who performed the work had the necessary knowledge and skills, rather than on an overall assessment of the engagement (i.e., an overall assessment of conformity with generally accepted accounting principles and compliance with generally accepted auditing standards)
- More in-depth, subjective examinations in the QPRs of the areas reviewed
- Having a member of the Panel staff conduct an extensive debriefing session with the QPR reviewer at the conclusion of each engagement review
- Holding focus group meetings in the QPRs of managers and seniors in each office reviewed
- Not preparing "matter sheets" in the QPRs that describe the deficiencies noted by the reviewers
- Not preparing reports or letters of comments on individual offices or firms in the QPRs

3 During the Panel's development of the QPR, various constituencies, including the SEC, the POB, practitioners, the Panel and the Panel staff, identified specific areas that directly affect the overall effectiveness of an audit. The Panel determined that the QPR should focus on these specific areas. The QPRs examined these areas in more depth than the SECPS peer reviews typically do. These areas included:

- Risk assessments, including engagement risk, fraud risk, inherent risk and control risk
- Controls, especially those related to information technology
- Linkage of risk assessments to tests of controls and substantive tests
- Substantive procedures, including substantive analytical procedures, in selected areas
- Completion of the audit, including the resolution of issues, non-standard entries, final analytical review and waived adjustments
- Communications with audit committees
- Revenue recognition, asset impairments, and merger-related and restructuring reserves

4 The QPR reviewers sought to obtain an in-depth understanding of the engagement teams' thought processes in the areas reviewed. The QPR reviewers used in-depth interviews and reviews of working papers to obtain this understanding. All instances in which the QPR reviewers disagreed with the quality or sufficiency of the engagement teams' work were referred to the firms for appropriate follow-up.

5 Matter sheets, reports and letters of comments were not prepared during the QPRs to increase openness and candor and reduce the reviewees' defensiveness. The goal of the QPR was not to assess and report on specific offices or firms; rather, the purpose was to assess and report on the overall effectiveness of public company audits performed by the large firms. In order to elicit frank responses and full cooperation from those reviewed, the Panel agreed to hold the specific engagement results in confidence. Accordingly, the results of the QPR have been summarized on an overall basis that combines the results of all offices and firms.

QPR SCOPE

6 All the companies whose audits were reviewed were SEC registrants. The reviews covered the eight largest accounting firms in the United States, namely, the Big 5 firms of Arthur Andersen LLP, Deloitte & Touche LLP, Ernst & Young LLP, KPMG LLP and PricewaterhouseCoopers LLP, as well as the three next largest firms, BDO Seidman, LLP, Grant Thornton LLP and McGladrey & Pullen, LLP.

7 To facilitate the selection of the individual offices to be reviewed, the Panel staff requested these firms to provide detailed demographic information by office.¹ The staff selected the offices to be reviewed to achieve diversity in their size, geographic location, clients and risk characteristics. For each of the Big 5 firms, the Panel staff selected four offices. The Panel staff selected only two or three offices for each of the other three firms because of their smaller size. In all, audit engagements at 28 offices were reviewed.

8 The selected offices then were requested to provide detailed demographic information about each SEC registrant audited by the office, as well as information regarding certain office-wide quality control and risk matters.² The Panel staff used this data, as well as other information,³ to determine the specific engagements to be reviewed. The engagements were chosen to achieve a diverse sample of engagements in terms of size, industry and engagement characteristics.⁴ For the Big 5 firms, the Panel staff generally selected five engagements per office, resulting in approximately 20 engagements reviewed for each firm. For the other three firms, the Panel staff selected approximately 10 engagements per firm to review. Overall, the staff selected 130 engagements, of which results were tabulated for 126 engagements representing 320,790 audit hours. The other four engagements were used to pilot test the QPR process. Based on the pilot tests, the staff made certain modifications to the QPR questionnaire to improve the effectiveness of the QPR process. The Panel members exercised oversight throughout the selection process.

QPR PROCESS

9 The firms' regular peer reviewers (from another audit firm) conducted the 28 office reviews under the close supervision of the Panel staff, including at least one senior member of the Panel staff. Virtually all the reviewers were partners with relevant industry and SEC experience.

Training

10 Before the QPRs were performed, the Panel staff conducted a training session for the eight firms' QPR coordinators and the review team captains from the reviewing firms. One member of the POB, a Panel member, and members of the staffs of the AICPA, SEC, POB and SECPS also attended the one-day session.

11 At the beginning of the review in each office, the reviewers and reviewees attended an orientation session conducted by the Panel staff. The purpose of these training and orientation sessions was to explain the purpose and objectives of the QPRs, how they

¹ See Table 1, Demographics Considered in Office Selection.

² See Table 2, Demographics Considered in Engagement Selection.

³ Other information included the "Top 50" restructuring charges, in-process research and development charges, merger charges, and write-downs in 1998; information regarding the fastest growing companies; and the SEC's "hot topics."

⁴ See Table 3, Industries of Reviewed Engagements, Table 4, Audit Hours of Reviewed Engagements, and Table 5, Engagement Characteristics of Reviewed Engagements.

differed from the SECPS peer reviews and how the Panel would use the results of the reviews.

Office Reviews

12 Each office review was approximately one week long and consisted of:

- An interview of the partner-in-charge of the office's audit practice
- Discussions with groups of audit seniors and managers (referred to as "the focus groups")
- Engagement reviews comprising interviews of engagement personnel, reviews of selected working papers and completion of the QPR questionnaire
- Interviews of the consulting partners responsible for the delivery of non-audit services, if any, on the engagements reviewed
- An exit conference with office management

13 Panel members attended most of the office reviews, participated in the focus groups and interviews, and observed the engagement reviews.

Interview of the Partner-in-Charge

14 The interview of the partner-in-charge of the office's audit practice focused on the adequacy of the professional development of auditors, the overall "tone at the top" in the office, and the performance measures used by the office in evaluating, compensating and promoting audit personnel. The partner's views on audit effectiveness and governance of the profession also were obtained. The QPR team captain conducted the interview, which was attended by a member of the Panel staff, and in many instances by one or more Panel members.

Focus Groups

15 The objective of the focus group discussions was to provide the Panel with added insight from audit seniors and managers about matters that they viewed favorably and matters that they believed needed improvement or would require changes in the future. There were two focus group meetings in most offices, one comprising five to eight senior managers and managers, and another comprising a similar number of seniors. At some of the smaller offices, one combined focus group meeting of managers and seniors was held. The focus group participants generally were not assigned to the engagements being reviewed. The sessions, which were conducted by the Panel staff, addressed such topics as the environment, auditors' knowledge and skills, and audit methodology. In many instances, one or more Panel members attended the sessions.

Engagement Reviews

16 The engagement reviewers began the review process by reviewing information from the prior year's audit and making their own preliminary risk assessments before interviewing the engagement partner, concurring partner, manager, senior and selected staff. Then they reviewed selected working papers based on the information obtained. The reviewers documented their observations and findings by completing a detailed questionnaire that included basic and supplemental sections. Panel members and staff participated in some of the interviews.

The Basic Questionnaire

17 The basic questionnaire included 426 data gathering, evaluative, best practice and improvement questions, as well as space for the reviewer's comments. The questionnaire was designed to elicit narrative responses from the reviewers to help identify best practices and areas for improvement and to eliminate the "check the box" mentality that can occur when questionnaires are used to gather information. The data gathering and evaluative questions were organized in a manner that was consistent with the audit risk model. Panel members reviewed and commented on the questionnaire before it was issued.

18 The questionnaire covered the following areas at the financial statement level:

- Engagement risk assessment and linkage to the inherent risk and control environment assessments
- Inherent risk and control environment assessments
- Fraud risk assessment

19 The reviewers generally selected three high-risk areas for review as well as one material area that the engagement team had assessed as having "low" or "moderate" (i.e., not high) risk. For these areas, the reviewers evaluated the:

- Inherent risk assessment
- Internal control risk assessment and evaluation
- Linkage of risk assessments (inherent, control and fraud risks) to substantive tests
- Design and performance of substantive tests

20 In order to obtain data regarding other important areas that affect audit effectiveness, the questionnaire required the reviewers to consider:

- Completing the audit
 - Resolution of issues
 - Non-standard entries

- Final analytical review
- Relations with the audit committee
- Personnel assigned to the engagement and changes in the engagement in recent years

21 The reviewers had to make numerous subjective evaluations when completing the questionnaire. These judgments related to the quality of the audit work performed, the knowledge and skills of those who performed the work, and whether the reviewer agreed with the engagement team's decisions. The reviewer's judgments on these matters were not limited to the engagement team's compliance with firm policies or professional standards, since the purpose of the QPRs was to address change and identify potential improvements.

The Supplemental Sections

22 The reviewers completed the following supplements to the basic questionnaire when they were applicable:

- Fraud risk assessment – misappropriation of assets
- Use of internal audit
- Revenue recognition
- Merger-related and restructuring reserves
- Impairment of long-lived assets and long-lived assets to be disposed of
- Going concern/severe liquidity
- Multi-location audits
- Non-audit services
- Former firm personnel in client management

23 Also, the reviewers described the audit approach in each of the four key areas and completed a supplemental questionnaire on the use of analytical procedures as substantive procedures in five additional areas that the reviewers selected with guidance from the Panel staff.

Debriefing Sessions

24 At the end of each engagement review, the reviewer met with a Panel staff member to communicate the reviewer's findings and evaluation of the engagement, with emphasis on the:

- Appropriateness of the risk assessments
- Level, general business and industry experience/expertise, knowledge and skills of those who performed and reviewed the work

- Nature, timing and extent of the partner's involvement in the engagement
- Nature and extent of the controls testing and substantive procedures performed, including the use of analytical procedures as substantive procedures
- Adequacy of documentation in the areas reviewed

Panel members attended some of these sessions.

QPR Exit Conferences

25 An office exit conference was held at the completion of the QPR process in most offices to summarize the results of the review. The conferences were conducted by the QPR team captain and generally were attended by the office's accounting and auditing leaders, a Panel staff member and, in some offices, a Panel member.

26 An overall exit conference was conducted with most of the firms to summarize and discuss the firm's overall QPR results. The firm's accounting and auditing leaders generally attended the meeting, which focused on the scope of the QPR and the best practices and areas for improvement noted during the review.

TABLE 1

Demographics Considered in Office Selection

To facilitate the selection of the individual offices to be reviewed, the Panel staff requested the eight firms to provide the following information by office:

- Audit engagement hours for the most recent 12-month period
- Number of audit partners
- Number of other audit personnel
- Average hours per audit partner
- Ratio of other audit personnel to audit partners
- Number of SEC engagements
- Number of IPOs effective since December 31, 1997
- Number of new SEC clients for which the firm's first report covered a period ending after November 30, 1997, with separate identification of the number of clients for which the predecessor auditors had resigned or reported a disagreement
- Number of SEC engagements with management consulting fees that exceeded the audit fees
- Number of SEC engagements considered "high risk"
- Number of cases reported to the Quality Control Inquiry Committee since January 1, 1997
- Number of restatements issued since December 31, 1997 (both SEC and non-SEC clients)
- Number of withdrawals of opinion since December 31, 1997 (both SEC and non-SEC clients)
- "Top five" industries by audit hours

TABLE 2

Demographics Considered in Engagement Selection

The selected offices were requested to provide detailed information by SEC registrant including:

- Engagement hours, industry, revenues, percentage of assets used in foreign operations and percentage of revenues from foreign operations
- Whether the following characteristics were present:
 - Significant derivative financial instruments
 - Going concern issues
 - Revenue recognition issues
 - In-process research and development (IPR&D) charges
 - Restructuring charges
 - Significant use of electronic data interchange (EDI)
 - Internal audit outsourcing services provided by the firm
 - IPO effective since December 31, 1997
 - The firm's first report covered a period ending after November 30, 1997
 - The firm's first report covered a period ending after November 30, 1997 and the predecessor auditors had resigned or reported a disagreement
 - The management consulting fees exceeded the audit fees
 - The client is considered "high risk"
 - A reproposal within the past three years
 - A partner or manager had left the firm to become the client's chairperson, CEO, COO, CFO or controller within the past three years

In addition, the selected offices were asked to list any:

- Cases reported to the Quality Control Inquiry Committee since January 1, 1997
- Restatements issued since December 31, 1997 (both SEC and non-SEC clients)
- Withdrawals of opinion since December 31, 1997 (both SEC and non-SEC clients)

TABLE 3**Industries of Reviewed Engagements**

Industry	Number of Engagements
Manufacturing	28
High technology	25
Financial services	17
Telecommunications	14
Consumer business	12
Health care	8
Real estate	8
Utilities	8
Gaming	2
Transportation	2
Aerospace & defense	1
Travel	1
Total engagements	126

TABLE 4**Audit Hours of Reviewed Engagements**

Audit Hours	Number of Engagements	% of Total Engagements
0 – 500	18	14%
501 – 1000	27	21%
1001 – 2000	38	31%
2001 – 3000	15	12%
3001 – 4000	10	8%
4001 – 5000	4	3%
More than 5000	14	11%
Total engagements	126	100%

TABLE 5**Engagement Characteristics of Reviewed Engagements**

Engagement Characteristics	% of Total Engagements
Initial audits	15%
IPO within the past 3 years	25%
Predecessor auditors resigned or declined to stand for re-election	6%
Client classified as "high risk"	44%
Reproposal within the last 3 years	6%
Restated financial statements in the past 3 years	11%
Significant use of EDI	13%
Foreign operations	44%
Work of a specialist used	33%
Significant work referred to an affiliated firm	24%
Significant work referred to an unaffiliated firm	4%
Significant work referred to other U.S. offices	12%
Internal audit was given significant audit consideration	16%
Restructuring charges or reserves	29%
Impairment of long-lived assets	28%
Going concern issues	39%
Revenue recognition issues	27%
Merger-related charges or reserves	20%
In-process R&D write-offs	6%
Significant use of derivatives	7%
Significant audit adjustments	29%
Significant disagreements with management	0%
Services other than audit or tax provided	29%
Former partner or manager of the firm in position of client chairperson, CEO, CFO, COO or controller	13%
Communications about fraud or illegal acts	8%
Communications about reportable conditions	12%

APPENDIX F – ANALYSIS OF SEC ACCOUNTING AND AUDITING ENFORCEMENT RELEASES

SCOPE AND METHODOLOGY

1 The Panel studied recent SEC Accounting and Auditing Enforcement Releases (AAERs) to supplement the Quasi Peer Reviews and held discussions with the SEC staff regarding the apparent causes of actual or alleged instances of fraudulent financial reporting and audit failures. The Panel's objective was to obtain additional insights regarding the characteristics that frequently were present in these matters, as well as insights regarding the auditors' work that either resulted in detecting or not detecting material misstatements. The Panel used those insights to identify lessons that might be useful in improving audit effectiveness and in helping to develop some of the recommendations in this report, especially in Chapters 2 through 4.

Scope

2 The study, which was conducted by Professor Thomas Weirich of Central Michigan University, covered the AAERs issued from approximately July 1, 1997, through December 31, 1999, involving the Big 5 firms or their clients. The Panel limited the study to the Big 5 firms and their clients because the Big 5 firms audit the most SEC registrants and because most of the Panel's efforts have focused on the effectiveness of their audits. The study included 96 AAERs involving 38 different matters.

Methodology

3 After reading the AAERs, Professor Weirich met with members of the staff of the Office of the Chief Accountant of the SEC to discuss each case. The discussions focused on:

- The root causes of or contributing factors to an effective or ineffective audit
- The auditors' actions, including what they did right and what they did wrong
- Any implications for the audit risk model
- The steps that could or should have been taken to prevent or detect the alleged financial reporting or audit failure
- The systemic and quality control implications
- The penalties (if any) the SEC assessed against the auditors
- The client personnel involved
- The client personnel's apparent motivations for materially misstating the financial statements
- The methods the client personnel apparently used to misstate the financial statements

4 The SEC staff answered questions using the information contained in the SEC's non-public enforcement files. Professor Weirich did not have access to those files. To help structure his discussions with the SEC staff, Professor Weirich developed a questionnaire that members of the Panel and its staff reviewed. After his meetings with the SEC staff, Professor Weirich prepared a written summary of the key elements of each case, including the auditors' actions during the audit, if those actions were known.

5 Subsequently, the Panel's staff director met for a total of five full days with Professor Weirich and members of the SEC staff to review and discuss each of the cases, spending more than an hour on average on each case.

6 Two significant limitations of this study were:

- While the SEC staff routinely examines the auditors' involvement in each case, the SEC's files generally did not contain much or any information about the auditors' work unless the auditors were named in the AAER, which happened in seven of the 38 cases.
- Professor Weirich did not have direct personal access to the SEC's files because they contain non-public information. Instead, he had to rely on the SEC staff's responses to his questions.

FINDINGS

Overview

7 The SEC named the auditors in seven of the 38 cases, and may name the auditors in others where the SEC has not completed its investigations. In those cases where no actions were brought against the auditors, the reasons included: there was insufficient evidence to support an action against the auditors, only unaudited interim financial statements were misstated, and the auditors discovered the misstatements. For instance, in 12 of the 38 situations, the auditors discovered the fraudulent activities, reported them to the audit committee and resigned or required restatements, or both.

8 There appeared to be substantial variations in the quality of the audits. At one extreme, the auditors appeared to have performed extremely thorough audits under the leadership of heavily involved, highly skeptical partners and managers who were able to ferret out well-concealed, massive, collusive frauds. At the other extreme, inexperienced auditors appeared to have been virtually unsupervised, overlooked seemingly obvious "red flags" and failed to follow up adequately on exceptions noted during their audit tests.

Accounts Frequently Misstated

9 Most of the misstatements involved relatively routine transactions and accounts rather than complex judgmental areas and more esoteric transactions and accounts, such as derivatives or other complex financial instruments, restructuring reserves, business combinations or in-process research and development charges.

10 The most frequently misstated transactions and accounts were:

Revenue and accounts receivable	26 cases (out of 38)
Expenses	13
Cost of sales and inventory	9
Sales discounts/returns and allowances	8
Property, plant and equipment	7
Accounts payable and accrued liabilities	5
Securities valuations	3

11 These findings are consistent with those of the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in its research study, *Fraudulent Financial Reporting: 1987–1997, An Analysis of U.S. Public Companies*.

Common Techniques for Overstating Revenue

12 As indicated above, approximately 70% of the cases in the study involved the overstatement of revenue—either premature revenue recognition or fictitious revenue. The most frequent techniques for overstating revenue were:

- Recognizing revenue contrary to agreements with customers, including:
 - Recognizing revenue on consignment sales
 - Recognizing revenue despite having entered into side agreements
 - Recognizing revenue on conditional sales to related parties
 - Recognizing revenue on bill and hold transactions
 - Inflating invoices in kickback schemes
 - Recognizing revenue when the risks and rewards of ownership had not passed to the customer
 - Recognizing revenue on shipments not ordered by customers
 - Recognizing revenue on non-qualifying barter transactions
- Manipulating cut-off, including:
 - Recording revenue on shipments after year end by backdating shipping documents

- Delaying the recognition of returns
- Generating fictitious transactions, including:
 - Recognizing fictitious revenue with false journal entries
 - Recognizing fictitious revenue on shipments of mock products or obsolete inventory
 - Recognizing fictitious revenue on shipments to public or company warehouses

13 In many instances the entity used more than one of the preceding techniques to overstate revenue. Many of these techniques are similar to those identified in the COSO report.

Other Factors Associated with Materially Misstated Financial Statements

14 During the study, Professor Weirich noted:

- Numerous instances where entities used information technology to facilitate material frauds, such as by making inappropriate modifications to computer programs, recording hundreds of small non-standard entries rather than a few large ones, or “freezing the date” in the computer system
- Numerous instances where non-standard entries were used to conceal misstatements
- A few instances of materially misstated financial statements resulting from the misappropriation of assets
- Several instances where the entity’s inherent risk apparently increased as a result of significant changes in the entity’s business (e.g., the loss of one or more major customers or the existence of a new competitor with a better, cheaper product), and the auditors apparently were not aware of these changes or did not accurately assess how they increased inherent risk
- Numerous instances where management had overridden controls, including controls over aging accounts receivable, recording shipments, changing computer programs and classifying disbursements. Because the auditors seem to have been unaware that management was overriding controls, they apparently assessed control risk and fraud risk as considerably lower than they actually were.
- Several instances of material fraud, either fraudulent financial reporting or misappropriation of assets, at relatively small divisions or subsidiaries. In some of these instances, the auditors apparently had not visited the locations in several years even though the entities did not have any internal auditors, controls at the locations were weak, or competition for the locations’ products had increased substantially, thereby increasing the risk at the locations.

- Numerous instances where the auditors' substantive procedures apparently were not adequate to detect material misstatements. Examples included:
 - Inadequate (small) sample sizes¹
 - Not adequately following up on exceptions noted on, or fax responses to, confirmations
 - Not adequately testing the following: the approval process for sales, sales or inventory cut-offs,² charges to asset accounts, or the valuation of securities or property, plant and equipment
 - Not controlling the confirmation process or not confirming the terms of large or unusual sales transactions, especially those that occurred at year end
 - Not ascertaining whether the financial statements agreed or reconciled with the accounting records
 - Over-relying on management's representations (i.e., not obtaining sufficient evidence to corroborate or refute management's representations, such as management's explanations for unusual fluctuations noted when performing analytical procedures)
 - Not testing the accuracy of computer-prepared schedules
- Various instances where the auditors apparently were not aware of, or did not pay sufficient attention to, such factors as negative cash flows, extended sales terms, customers taking longer than usual to pay, increased product returns, or very large percentages of sales being recorded at the end of periods
- A very limited number of situations where the external auditors may not have tested, supervised and reviewed the internal auditors' work as thoroughly as would have been desirable
- Some instances where the personnel assigned to audit certain areas, such as receivables and inventories, did not appear to have sufficient training and experience or to be adequately supervised

In many of these situations, the auditors appeared to have demonstrated a lack of sufficient professional skepticism.

15 Professor Weirich also noted that the entities with the most sophisticated frauds often were very concerned about concealing them from the auditors and ensuring that "the numbers and the relationships among them would 'look right' to the auditors when they performed their analytical procedures." A favorite technique for accomplishing this was to "play around" with the numbers, often through the use of non-standard entries, until they "looked right." In these circumstances, key ratios such as the accounts receivable

¹ In several situations, cut-off tests were limited to examining the documentation for a very small number of transactions.

² See note 1.

and inventory turnover ratios and the gross margin percentages presumably met the auditors' expectations rather than raising questions that might have revealed the fraud.

16 In a limited number of instances, succumbing to time pressures may have contributed to the auditors' failure to detect material misstatements, while in others, the auditors' resistance to time pressures may have facilitated their detection of the misstatements.

Fraud Participants and Incentives for Committing Fraud

17 In most of the 38 cases, one or more members of top management were involved in or aware of the activities that resulted in the materially misstated financial statements. For example, the CFO apparently was involved in almost two-thirds of the cases, the CEO in almost one-half, and the controller in almost one-half. In some situations, numerous lower-level personnel (such as accounting clerks, district sales managers, or personnel in the IT department who reprogrammed the computer to conceal the fraud) also were involved in or at least aware of the activities.

18 In still other situations, top management apparently was unaware that the overall financial statements were materially misstated, since the fraud was perpetrated at a subsidiary or division where the personnel apparently were trying to either "make the numbers" or cover up their misappropriations of assets. Finally, in a few situations, third parties were involved in attempting to conceal the fraud, such as by sending false confirmation responses to the auditors.

19 In five situations, one or more of the members of management involved in the misstatements had been with the audit firm, in three situations as partners, prior to joining the company.

20 The personnel involved in making the misstatements are reported to have cited various incentives for participating, including:

- Meeting analysts' expectations
- Meeting corporate earnings targets
- Raising additional capital
- Complying with financial covenants for loans or lines of credit
- Reporting favorable results for an IPO
- Earning bonus awards or stock options
- Satisfying NASDAQ listing requirements
- Funding personal expenses

APPENDIX G – FOCUS GROUPS

1 Eleven focus group sessions were conducted to obtain information on topics relevant to financial reporting and audit effectiveness. An independent professional facilitator and a Panel staff member led the sessions, which lasted about three hours. At least one Panel member attended almost every session. (These sessions were in addition to those held in conjunction with the Quasi Peer Reviews.) The groups included:

- Practicing professionals from the eight large firms – A total of eight sessions were held in New York, Atlanta, Chicago and San Francisco. Each included one individual from each of the eight large firms that participated in the Panel’s project. All of the participants at each session had the same level of experience. The eight sessions covered a cross-section of experience levels, as follows:

	<u>Years of Experience</u>	<u>Number of Meetings</u>	<u>Number of Participants</u>
Staff	1-2	1	8
In-charge	3-5	3	24
Managers/Supervisors	5-11	2	16
Experienced managers	11-14	1	8
Partners	12+	1	8

- Chief financial officers and controllers – One session of financial executives of SEC registrants. All were members of the Financial Executives Institute. The companies represented were:

Bethlehem Steel Corporation
General Electric Company
ITT Corporation
Tenneco Inc.
Union Carbide Corporation

- Internal audit executives – One session of executives, mostly from SEC registrants. All were members of the Institute of Internal Auditors. The companies represented were:

Asea Brown Boveri Inc.
Bell Atlantic Corporation
International Business Machines Corporation
Lucent Technologies Inc.
Praxair, Inc.
Readers Digest Association Inc.
Texaco Inc.

Pitney Bowes Inc.

- Partners from smaller firms – one session of eight partners experienced in conducting peer reviews of smaller firms.¹ The firms represented were:

Barnes, Dennig & Co.
Cherry, Bekaert & Holland, LLP
Hanson, Barnett & Maxwell
Hevia, Beagles & Company, P.A.
Larson, Allen, Weishair & Co. LLP
Urbach Kahn & Werlin P.C.
Virchow, Krause & Company, LLP
Weaver and Tidwell LLP

2 Different topics were emphasized depending on the experience and background of the participants. The topics were identified by the Panel and included the following:

- *The value of an audit* – as seen by management, audit committees, investors, other users and auditors
- *The audit environment* – governance of firms and the profession, messages about audit quality, personnel issues (recruiting, turnover, salaries), personnel performance measures, fee competition and earnings management
- *Audit methodology* – understanding the client's business and risks, internal control, detailed audit tests and the effects of technology on audits
- *Fraud* – auditors' responsibilities and abilities to detect material financial statement frauds
- *Knowledge and skills of audit professionals* – self-development, technology skills, technical and industry knowledge, and on-the-job learning
- *Professional standards* – individual accounting and auditing standards, and standard setting
- *Audit committees* – roles, responsibilities and relationships with auditors
- *Practice economics* – practice development and growth, profitability, fee competition and time pressures on engagement teams
- *Auditor independence* – the effects of non-audit services on auditor independence
- *The SEC* – its role and responsibilities; relationships with the SEC staff

¹ See Appendix K for additional information.

APPENDIX H – SURVEY

1 The Panel’s project contemplated gathering information from key audiences using a variety of means. Early in the project the Panel decided to seek information about a wide range of issues from a number of sources through a mail survey, “Request for Opinions on Issues of Audit Effectiveness Addressed to Thought Leaders and Key Stakeholders.” The survey was issued on September 1, 1999.

2 The survey was not intended to be an opinion poll. Rather, the Panel encouraged each respondent to give free-form responses to as many of the questions as possible from that person’s unique perspective. The Panel also informed all potential respondents that their responses would be held in confidence and would not be available for public inspection.

CONSTITUENCIES RESPONDING

3 The intent of the Panel was to seek the views of many constituencies. Toward that end, the Panel addressed the survey to a number of selected individuals and organizations. Among the constituencies surveyed were preparers and users of financial statements, auditors, regulators, academicians, lawyers and analysts. While the list of those initially selected was broad, the Panel did not limit responses to those on the list. Rather the views of everyone interested in the Panel’s project were welcomed. The survey questionnaire was included on the websites of the AICPA and the SEC for anyone to obtain and answer.

4 An analysis of the constituencies included in the Panel’s original mailing and the constituencies responding follows:

<u>Constituency</u>	<u>Original Mailing*</u>	<u>Responses*</u>
Accounting firm personnel	46	15
CPA organizations or personnel	157	18
Legal firm personnel	36	2
Governmental organizations	80	9
Management organizations	16	4
Corporate management	15	7
Investment management or analysts	88	7
Public interest organizations	56	9
Academia	<u>43</u>	<u>19</u>
Totals	<u>537</u>	<u>90</u>

* Some individuals or organizations could fit into more than one category.

SURVEY QUESTIONNAIRE

5 The survey was designed to provoke thought by setting forth points of view in a number of areas, with related questions for respondents to address as they saw fit. The areas explored in the survey were:

1. The Business Environment
2. Responsibilities for Detecting Financial Statement Fraud
3. The Audit Risk Model
4. Breadth of Auditors' Involvement
5. Audit Committees and Auditors' Communications
6. The Auditing Profession
7. The Business of Auditing
 - i) The effects of competition
 - ii) Scope of services offered by audit firms
 - iii) Organizational structures
 - iv) Litigation
8. Regulation and Self-Regulation
 - i) Roles and responsibilities
 - ii) Auditing standards
 - iii) The AICPA and audit firms
9. Costs, Benefits and Other Issues

A copy of the survey questionnaire is included at the end of this appendix.

ANALYSIS OF SURVEY RESPONSES

6 The Panel reviewed all of the survey responses. The details of each response were related to the applicable question or questions in the survey. Matters appearing to be of common interest and common themes were identified and discussed. In general, the Panel addressed:

- Key substantive observations made in response to each of the survey's questions
- Specific recommendations for Panel action or non-action
- Comments about the Panel's project, process and scope
- Specific ideas for enhancing audit effectiveness, including incentives and disincentives
- Other ideas for enhancing investor protection, not necessarily directly involving auditing or auditors
- Cost-benefit considerations and recommendations

7 The information that the Panel received from the survey was valuable in its deliberations and in formulating many of its recommendations. The Panel expresses its appreciation to all respondents for their efforts and the quality of their responses.

COPY OF THE QUESTIONNAIRE

8 A copy of the survey questionnaire is reproduced below.

C. The Questionnaire

Each section of the questionnaire begins with an introductory paragraph, setting out some points of view that you may or may not agree with, and that are not necessarily representative of the views of the Panel. Please feel free to consider these points of view in forming your responses to the questions that follow, or set them aside, as you see fit. They are merely meant to provoke thought.

1. The Business Environment

Auditors operate in an environment of increasing complexity, accelerating change and intense business competition. There is significant merger and acquisition activity, newer and more complex financial transactions and instruments to hedge or mitigate risks, and more intangible or “soft” assets on corporate balance sheets than ever before. Businesses often change strategic directions giving rise to restructuring activities with corresponding reserves set aside to cover the anticipated costs of those activities. Accounting standards address many of these areas, but they often are subject to varying interpretation. In preparing financial reports, management must rely far more on making informed judgments and estimates about the effects of future events and transactions.

Core Questions

- Are auditors devoting sufficient attention to the areas where management discretion and judgment are required in financial reporting? If not, please explain why you believe this.
- To what extent do analysts’ earnings estimates influence management’s judgments in preparing financial statements, and what are the effects on the auditor? If you see any effects, please elaborate on their importance.
- Do accounting standards issued in recent years help or hinder auditors in meeting the needs of users of financial statements? If they hinder auditors, how do they do so and what should be done?

Extended Question

- Analysts' earnings per share estimates establish expectations (sometimes to the penny) in the marketplace for companies to achieve. Can audits ever be expected to be this exact? If not, what should be done, if anything, to deal with this situation?

2. Responsibilities for Detecting Financial Statement Fraud

Under current auditing standards, auditors have the responsibility to assess fraud risks and obtain reasonable assurance that the financial statements are free of material misstatement, whether caused by error or fraud. This is not the same as saying that audited financial statements are a "guarantee" that fraud has not taken place. Investors clearly place some responsibility for the detection of fraud in the hands of auditors, but the extent of these responsibilities often is unclear to many of those involved in the financial reporting process.

Core Questions

- Are auditors' responsibilities with respect to the detection of deliberate misstatements of earnings appropriate? Please explain your view.
- What are users' views of those responsibilities and are they realistic? Please feel free to elaborate on differing views of various types of users, such as individual investors and institutional investors.
- What, if anything, should be done to change these views, or to change auditors' responsibilities for detecting fraud?

3. The Audit Risk Model

Audits are conducted using an "Audit Risk Model" that requires auditors to use their judgment in assessing risks and then in deciding what procedures to apply. The model allows auditors to take the client's business, financial and other circumstances into account in selecting their audit approach. This model can be applied differently by different audit firms, so long as they comply with "generally accepted auditing standards."

Core Questions

- Is this model, where auditors are encouraged to use their judgment in selecting their audit approach based on the individual company's nature and circumstances, appropriate? Please elaborate on your point of view.
- What are the best safeguards to make sure that auditors exercise this judgment in ways that protect shareholders and other investors?

Extended Questions

- Does this model allow too much chance that errors in auditors' judgments will result in problems for investors?
- Does the model require auditors to explore in sufficient detail the accounting policies and procedures that individual companies use?
- Does the model meet the expectations of the investment community in constraining inappropriate management behavior, especially in judgmental areas?
- Is this model equally appropriate in all industries, or are there some where a different approach might be needed?
- Are auditors sufficiently equipped to deal with the growing role of information technology? What incremental skills are needed?
- Do auditors exert the right balance between efficiency and timeliness on the one hand and thoroughness on the other? Do you have any observations about the level of experience of auditors assigned to engagements, how they are supervised and their work reviewed, or the nature and extent of the audit documentation that they retain in their working papers?

4. Breadth of Auditors' Involvement

Some argue that, in light of increased business complexity, technology, new financial instruments, and other developments, auditors do not pay enough attention to business systems, management processes, unique industry factors and operational matters. According to these observers, auditors place too much emphasis on historical financial information and not enough on the current and future risks of managing the business and on the entity's communications with investors. Others believe that it would be impractical or inappropriate for auditors to focus more attention on these matters.

Core Question

- Do you believe auditors should be more involved in and familiar with their clients' business and operational matters and ongoing communications with the investment community? Please explain why you feel the way that you do.

Extended Questions

- Should auditors be more or less involved with:
 - internal controls

- interim financial statements
- forecasts
- management's discussion and analysis
- non-financial data
- Should auditors be required to report on such matters? If so, which matters and why?
- Would greater involvement in these areas improve the value of the independent audit?
- Would the costs of greater involvement outweigh the benefits?

5. Audit Committees and Auditors' Communications

A significant part of the debate about audit effectiveness has focused on the current and future roles of audit committees, including their roles in enhancing communications among themselves, the board, management, shareholders, and the auditors. Some believe that a stronger role for audit committees may be a necessary and helpful way of improving the effectiveness of audits. (The Panel does not intend to duplicate the work of the Blue Ribbon Committee on the Effectiveness of Audit Committees.)

Core Questions

- Do you believe auditors currently communicate effectively with:
 - management
 - audit committees
 - boards of directors
 - stockholders (feel free to elaborate on institutional versus individual investors)

Extended Questions

- Do you have any suggestions for improving the effectiveness of auditors' communications?
- Should auditors do more to assist audit or other committees of a board of directors?
- Are audit committees effective in promoting quality audits? How can audit committees be more effective in that regard? Do audit committees do enough to seek out auditors' opinions and input?

6. The Auditing Profession

Some have sensed that it is becoming more difficult to attract and retain young people in auditing as a career. Others believe that this has long been a challenge and that things are not so different today.

Core Questions

- Do you believe that the quality of new recruits into auditing has been declining in recent years, and if so, is this having an effect on the quality of audits?
- Are the opportunities and rewards in the auditing profession sufficient to attract and retain high quality entrants? (Please separate the question of attracting versus retaining as you see fit.) If not, what more should be done to attract and retain more high quality individuals over the long term?
- What are your views on audit personnel taking jobs with clients?

7. The Business of Auditing

i) The effects of competition

Audit firms operate in a highly competitive environment, and there is a debate about the effects of that competition on the quality of audits. While the largest five firms audit the preponderance of publicly held companies, changes in audit firms by publicly held companies are relatively infrequent. Some believe that competition improves the quality of audits while others argue that emphasis on competition weakens their quality.

Core Questions

- What are your views about the effects of competition and pricing on the quality of audits?
- How do you see time and budget pressures affecting the quality of audits?

ii) Scope of services offered by audit firms

Some believe that audit firms are placing less emphasis on audit work and more emphasis on other services they provide, thus weakening the quality of audits. Others assert that

non-audit work either has no effect, or actually helps audit firms perform better audits by keeping their skills and understanding of business more up to date.

Core Questions

- What are your impressions of the importance (stature, compensation, advancement, investments, etc.) audit firms place on audit work relative to the other services they offer, and how, if at all, does this affect the quality of audits?
- Do you believe non-audit services offered to audit clients affect the independence or perceived independence of auditors? If so, how do they do so and what should be done about this?
- Do firms properly balance the importance of high quality, independent audits with
 - The goal of practice growth and firm success?
 - The goal of client retention?
 - The goal of enhancing relationships with clients?
- Do firms place sufficient importance on professional qualifications, accounting and auditing training, specialized skills, experience and integrity of auditors?

iii) Organizational structures

Over the past decade, audit firms have diversified into a variety of services either by internal expansion or by acquisition. Furthermore, some non-audit organizations have acquired audit firms or parts of them.

Core Questions

- What are the effects of the following on the quality of audits:
 - non-audit organizations acquiring audit firms or parts of them?
 - audit firms broadening their range of non-audit services through acquisition or by internal expansion?
- Are current organizational structures appropriate to promote quality audits?

iv) Litigation

Some believe that litigation or the threat of litigation has a salutary effect on the quality of audits. Others assert that litigation has unreasonably driven up costs for audit firms, and combined with downward pressures on prices, may have weakened audit quality.

Core Questions

- What are your thoughts on the effects of litigation on the quality of audits?
- Will recent changes in federal or state laws affect the quality of audits? In what way?
- Are more changes to securities or other laws needed? If so, what changes?

8. Regulation and Self-Regulation

i) Roles and responsibilities

Currently, there is a wide array of practices in place to enhance audit quality, including oversight by regulatory bodies, self-regulation by professional associations, and policies and practices within each audit firm.

Core Questions

- Do you think that there is the right balance between regulation and self-regulation, insofar as enhancing audit quality is concerned?
- What changes, if any, would you suggest in the approaches taken by regulatory bodies, self-regulatory bodies, and individual firms to enhance audit quality?

ii) Auditing standards

Auditing standards are established by the Auditing Standards Board of the AICPA, a 15-member board comprising representatives from each of the five largest audit firms, eight other audit firms, a member of the academic community and a member from government. The SEC oversees the activities of the ASB.

Core Question

- Do “generally accepted auditing standards” and the way they are formulated meet the needs of the investment community? If not, what changes would be useful?

iii) The AICPA and audit firms

The AICPA exists to serve the accounting profession’s interests in a variety of ways, including speaking on behalf of the profession on topical issues. Audit firms, of course, speak on their own behalf and promote their own individual capabilities.

Core Question

- What would you like to see the AICPA and individual firms do to enhance the public’s trust and confidence in the auditing profession?

9. Costs, Benefits and Other Issues

Actions to improve the effectiveness of audits in protecting investors’ interests need to be justified in terms of their costs versus the benefits to be derived from them.

Core Question

- What recommendations would you like to see the Panel make, and how do you assess their costs and benefits?

The foregoing questions are intended to cover key issues relating to audit effectiveness. The Panel invites respondents to provide comments on issues that may not be addressed or adequately covered by this questionnaire. You may draw on personal experiences or observations, as you deem appropriate.

APPENDIX I – OCTOBER 1999 PUBLIC HEARINGS

1 The Panel conducted public hearings in October 1999 to gather information directly from leaders of all constituencies of the financial reporting process – investors, regulators, auditors, preparers, analysts, plaintiffs’ and defendants’ bars, standard setters and educators. Leaders of almost 30 organizations were invited to testify at the hearings, and most agreed to participate. Participants were asked to express their views on the current effectiveness of audits in protecting investors’ interests. Each participant made a presentation lasting 15–20 minutes, followed by questions from Panel members.

2 The following organizations were represented at the hearings¹:

American Accounting Association
American Bar Association, Committee on Law and Accounting
American Institute of Certified Public Accountants
Arthur Andersen LLP
BDO Seidman, LLP
Bear Stearns & Co.
Deloitte & Touche LLP
Ernst & Young LLP
Financial Accounting Standards Board
Financial Executives Institute
Grant Thornton LLP
KPMG LLP
McGladrey & Pullen, LLP
Milberg Weiss Bershad Hynes & Lerach
National Association of State Boards of Accountancy
New York Society of Security Analysts
PricewaterhouseCoopers LLP
Public Oversight Board
Securities and Exchange Commission
SEC Practice Section
Ten Eyck Associates
Wharton School of the University of Pennsylvania
Willkie Farr & Gallagher

3 The speakers were forceful and straightforward in their remarks, and responded candidly to Panel members’ questions. The Panel considered the information it received to have been very valuable in its deliberations and is grateful to the speakers for their outstanding participation.

¹ See Exhibit 3 to this report for a timetable of the presentations at the October 1999 hearings.

4 The views expressed by the speakers are referred to in the “Findings” sections of this report. Among the areas of recurring comments by the speakers were:

- Governance of the profession
- Financial statement and reporting models
- Non-audit services
- Recruiting new people to the profession
- Auditing revenue recognition
- Auditing reserves
- Auditors’ involvement in interim periods
- The “rate” of audit failures
- Encouraging employees to disclose fraud
- Earnings management
- Audit myths, including audits as loss leaders
- Alternative practice structures
- Risk-based audit model
- Effects of globalization
- The relationship between the SEC and audit firms

APPENDIX J – FIRM MATERIALS/MEETINGS WITH FIRMS

1 At the outset of the project, representatives of the Panel met with some of the leaders of the accounting and auditing practices of the eight largest firms. These meetings generally included the partners responsible for the firms' U.S. accounting and auditing practice and for activities related to professional education; risk management, including client acceptance and continuance; professional standards; internal consultation; and methodology development and implementation. The objective of these several-hour meetings was to obtain the firms' views on the accounting and auditing environment and the issues the Panel should consider, including:

- *Expectations of auditors*, including by management, audit committees, boards of directors, shareholders, other users and auditors
- *Personnel*, including recruiting and the availability of quality people, knowledge and skills, performance measures and employee turnover
- *Audit methodologies*, including the risk-based model, the effects of technology, and auditors' responsibilities for detecting fraud
- *Accounting and auditing standards*, including the processes for developing and implementing them, and ideas about necessary changes
- *Governance issues*, including, in particular, the roles of the SEC, AICPA and POB
- *Independence matters*, including the effects, if any, of non-audit services performed by auditors

2 The partners also provided the Panel with in-depth information and explanations about changes in their audit methodologies and tools and related firm policies.

3 Separately, the firms provided additional information and statistics on a variety of topics for the Panel's use in developing its findings and recommendations. The topics included:

- Audit policies, procedures, guidance materials and practice aids
- Risk management – client acceptance and continuance
- Professional development activities, including instructor-led and self-study course catalogs and selected course content, coaching and mentoring programs, and average training hours per auditor by experience level
- Performance measurement and evaluation policies and procedures and related measurement tools
- Reward and incentive compensation programs for employees at each experience level
- Marketing publications designed to attract new audit clients or promote

additional services to existing audit clients

- Internal messages to staff, particularly relating to the importance of performing quality audit work, and external messages to clients and potential clients concerning audit quality
- Statistical data covering five-year trends in hiring, employee retention and employee work load and scheduling
- Success stories – examples of situations where audits uncovered material errors or fraud before the issuance of financial statements or where the auditor took a strong stand against overly aggressive accounting or client-imposed time pressures

APPENDIX K – SMALLER FIRMS

1 Over 80% of the audits of domestic SEC registrants are performed by the eight largest U.S.-based audit firms.¹ As a result, the Panel concentrated primarily on those firms and their audit methodologies. However, the Panel recognizes the important role that smaller firms that audit the remaining public entities play in our capital markets. (See also “Other Firms” in Appendix B.) Accordingly, the Panel staff reviewed and analyzed Practitioners Publishing Company’s “Guide to Risk-Based Audits” and “Guide to Audits of Small Businesses,” since these publications represent the core methodologies that a large number of smaller firms use.

2 In addition, the Panel staff met with a group of eight professionals experienced in conducting peer reviews of smaller firms (see Appendix G). These individuals are partners in firms ranging from fewer than 10 to more than 600 professionals, and in the aggregate they conducted nearly 100 peer reviews in 1999.

3 The discussions with these peer reviewers included a broad range of topics similar to the topics covered in meetings with the larger firms and in other focus groups, but from the perspective of the smaller firms. Substantial time was devoted to client acceptance and continuance policies and procedures; technical industry and specialist support for engagement teams, such as in the area of information technology; and the unique challenges these firms face as a result of changing technology and audit methodologies.

¹ Provided by SECPS staff.

APPENDIX L – MEETINGS WITH REGULATORS AND PROFESSIONAL BODIES

1 The Panel chairman, the staff director and other members of the Panel and its staff had numerous meetings with regulators, primarily the SEC, and various private-sector professional bodies involved in the governance of the profession or their representatives. During these meetings, the Panel representatives reported on the Panel’s activities and progress and discussed various issues and other matters of mutual interest to assist the Panel in gathering information and formulating its recommendations.

2 The groups the Panel or its staff met with and the number of meetings are:

Organization	Number of Meetings
Securities and Exchange Commission and its staff	18
SECPS Quality Control Inquiry Committee	8
Public Oversight Board	8
SECPS Peer Review Committee	6
Independence Standards Board and its staff	5
Auditing Standards Board and its staff	5
SECPS Executive Committee	5
SECPS Peer Review Process Task Force	4
SECPS Planning Subcommittee	4
CEOs of the Big 5 firms	2
Audit Issues Task Force	2
Committee on Corporate Reporting of the Financial Executives Institute	1
International Organization of Securities Commissions	1
Professional Ethics Executive Committee staff	1
International Auditing Standards Subcommittee of the Auditing Standards Board	1
International Auditing Practices Committee	1

APPENDIX M – PANEL MEETINGS

1 The Panel met 13 times for a total of 21 days. Portions of five meetings were open to the public, including representatives of the SEC, the press, the AICPA, the SEC Practice Section and the eight firms that participated in the Panel's project.

2 During its meetings, the Panel met with representatives of the AICPA and/or the SEC Practice Section (four times), the Public Oversight Board (four times), the SEC (twice) and the Independence Standards Board (once). The Panel heard presentations by representatives of some of those organizations on such topics as governance of the profession, including the feasibility of a Self-Disciplinary Organization; the supply and demand for entry-level accountants; and the results of the Independence Standards Board's research project that surveyed various constituencies on their perceptions of auditor independence and objectivity.¹

¹ Earncliffe Research & Communications, *Report to the United States Independence Standards Board - Research into Perceptions of Auditor Independence and Objectivity*, November 1999.

APPENDIX N – JULY 2000 PUBLIC HEARINGS

1 The Panel conducted public hearings in July 2000 to obtain views about its recommendations in the Exposure Draft of its report. Leaders of almost 20 organizations testified at the hearings. Each participant made a presentation of approximately 15 minutes, followed by questions from Panel members.

2 The following organizations were represented at the hearings¹:

American Institute of Certified Public Accountants
Arthur Andersen LLP
Auditing Practices Board (UK)
Canadian Institute of Chartered Accountants
Colorado State Board of Accountancy
Deloitte & Touche LLP
Ernst & Young LLP
Institute of Internal Auditors
KPMG LLP
National Association of State Boards of Accountancy
New York State Board of Accountancy
New York State Society of Certified Public Accountants
PricewaterhouseCoopers LLP
Securities and Exchange Commission
Texas State Board of Accountancy
Washington State Board of Accountancy

The following individuals also testified at the hearings:

Richard Antle, Professor, Yale School of Management
Thomas Craig, Professor, Illinois State University

3 The speakers were forceful and straightforward in their remarks, and responded candidly to Panel members' questions. The Panel considered the comments it received in completing its report and is appreciative of the speakers' participation.

¹ See Exhibit 5 to this report for a timetable of the presentations at the July 2000 hearings.

4 Some of the areas of recurring comments by the speakers were:

Governance of the profession, including the POB's proposed charter
Audit risk model
Non-audit services
Role of the state boards of accountancy
International aspects of the profession, including cooperation in standard setting
Forward-looking recommendations
Prioritization of recommendations
Management's responsibility for prevention and detection of fraud
Management reporting on internal control
Forensic-type auditing
Linkage between the Panel's findings and its recommendations

APPENDIX O – SIGNIFICANT CHANGES FROM THE EXPOSURE DRAFT

1 On May 31, 2000, the Panel issued the Exposure Draft of its *Report and Recommendations*. The Panel received comments on the Exposure Draft from participants at public hearings (see Appendix N) and from 42 individuals and organizations that submitted letters of comment. The Panel analyzed all the comments, deliberated again many of its recommendations and made a number of changes to its report. This appendix describes the most significant modifications. In addition, the final report includes updated information, clarifications and editorial improvements that are not described below.

Executive Overview

2 Significant changes made elsewhere in the report are reflected in “Recommendations.”

Chapter 1 – Introduction

3 The discussion of “Benefits and Costs” has been expanded. Also, changes made elsewhere in the report are reflected in “The Panel’s Approach to the Project” and in “Chapters Containing Findings and Recommendations.”

Chapter 2 – Improving the Conduct of Audits

4 Several commentators noted that not all the recommendations seemed to be supported by the findings from the Quasi Peer Reviews (QPRs). The Panel added an explanation that its recommendations spring from a variety of sources (not solely the QPRs), and are intended not merely to suggest improvements resulting from perceived deficiencies, but also to foster wider use of “best practices” that the Panel identified (paragraphs 2.20 – 2.21).

5 Also, some questioned whether the Panel’s call for more definitive auditing standards meant that the Panel was suggesting that auditors use more checklists and rely less on their judgment. The Panel has clarified that its intention was that better guidance be developed to help auditors enhance their professional judgment, not that more checklists be designed, and has added an example of definitive guidance in an existing standard (paragraphs 2.23 – 2.24).

6 The recommendations to the Auditing Standards Board (ASB) for “Multi-location Audits” and “Assessing Control Risk” have been expanded to include additional consideration of the control environment in determining audit scope.

7 The recommendations to the ASB regarding “Analytical Procedures” now include developing guidance for relying on and documenting management’s explanations.

8 In “Going Concern Considerations,” the Panel has noted in its recommendation to the Financial Accounting Standards Board that an international accounting standard addresses the subject of going concern, and that an international auditing standard references that accounting standard.

9 In “Communicating with Audit Committees,” the Panel has deleted the recommendations in the Exposure Draft addressed to the ASB, since they are substantially covered by existing guidance.

10 A recommendation has been added to “Establishing Auditing Standards” that the POB review the ASB’s prioritization, timetable and process for addressing the Panel’s recommendations. The Panel also has offered observations to the POB and ASB on this activity.

Chapter 3 – Earnings Management and Fraud

11 Changes to this chapter include:

- A new section, “Consideration of Exposure Draft Comments on the Forensic-type Phase”
- A notation that all the audits reviewed in the QPRs were subject to SAS No. 82 (note 27 to Chapter 3)
- Clarifying references to the goal of “zero defects” (paragraph 3.27)
- Clarifications to the recommendation that the ASB develop a forensic-type audit phase, including an expanded discussion of the degree of additional audit effort in this phase, the use of the word “forensic,” the neutral concept of professional skepticism, the use of internal auditors, high-risk areas and procedural guidance for interim periods
- An extension by one year of the timetable that the Panel believes is reasonable for strengthening standards in this area
- An additional recommendation to audit committees requiring management to acknowledge in writing that it has the primary responsibility for preventing and detecting fraud

Chapter 4 – Audit Firms

12 A brief discussion of “Collegiate Education” has been added to “Professional Development.” The recommendations to audit firms under “Professional Leadership – The Tone at the Top” and “Personnel Management” have been expanded (but not changed).

Chapter 5 – Auditor Independence

13 “The Panel’s Process” in “Non-audit Services” has been updated for the SEC’s June 2000 independence proposals, and a footnote reference to the Independence Standards Board’s conceptual framework project has been added.

Chapter 6 – Governance of the Auditing Profession

14 In “Proposed System of Governance,” the recommendations in the Exposure Draft have been substantially reorganized for clarity. In some cases, those to whom the recommendations are addressed have been changed to better direct the recommendations to the parties most capable of implementing them.

15 The Panel has recommended that the POB, SEC, AICPA, SECPS and major firms promptly agree to a charter for the POB, noting that there are two matters in the August 22, 2000, draft charter that are still under negotiation. Upon the successful conclusion of those negotiations, the Panel believes the charter will result in a major step forward in the governance of the profession (paragraph 6.26).

16 The Panel expanded its recommendation regarding the POB’s oversight of the profession’s activities to include the standard-setting activities of the AICPA’s Professional Ethics Executive Committee that relate to audits of public companies (paragraph 6.23).

17 A recommendation has been added that the POB and state boards of accountancy determine how best to facilitate communications between them (paragraph 6.28).

Chapter 7 – International

18 “The Goal of Transparency” has been clarified to emphasize that the cooperative efforts of all those involved in the financial-reporting and capital-raising processes are required to achieve the goal. The Panel has added a concluding recommendation that the ASB and the International Auditing Practices Committee initiate a formal collaborative effort to harmonize auditing standards and achieve their global acceptance.

Chapter 8 – Looking Ahead

19 “The Information Demand” and “The Best People” have been expanded to acknowledge the potential for changes to the current accounting model and other challenges in today’s “new economy.”

Appendices

20 Appendices N (July 2000 Public Hearings) and O (Significant Changes from the Exposure Draft) have been added.

Exhibit 1



OFFICE OF
THE CHIEF ACCOUNTANT

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

September 28, 1998

Mr. A.A. Sommer
Chairman
Public Oversight Board
One Station Place
Stamford, Connecticut 06902

Dear Al:

I am writing to you today to ask that the Public Oversight Board ("POB") examine whether recent changes in the audit process serve and protect the interests of investors. Perhaps the best way to approach such an examination is to convene a "blue ribbon" panel of investors, auditors, audit committee members, corporate executives, former regulators, and others with a keen understanding of the audit function. The panel could study the issues outlined below, invite public comments, and possibly hold public hearings.

As you are well aware, the Commission and the accounting profession have a long history of assuring that financial information reaching the marketplace is credible, relevant, and reliable. The foundation for this unique relationship was laid when Congress stated in the securities laws that issuers could access the public capital markets only if their financial statements are audited by independent accountants. This statutory franchise placed the accounting profession on a pedestal and charged the profession with the critical responsibility of enhancing investors' confidence in the financial information they receive.

Almost since its inception, the Commission has looked to the profession to take the lead in setting auditing standards. The Commission has overseen and participated in that standard setting process and, when necessary, enforced adherence to those standards. As a result of our efforts and the efforts of dedicated accountants serving in both management positions in public companies and in the auditing profession, investors have come to rely on the accuracy of financial statements when making investment decisions.

Recently, however, the combination of changes in the audit process and high profile financial frauds have raised questions about the efficacy of the audit process. For example, many auditors have changed their audit procedures to use a risk assessment model that places increased reliance on analytical procedures, while decreasing the use of substantive audit procedures, such as confirmations with debtors and detailed testing of transactions, account balances, and the activity in those accounts. This restructuring of the audit process has come at a time when the press has reported several frauds involving

materially and in some cases hugely misstated financial statements that appear to have gone undetected by auditors.

Some auditors assert that the changes to their processes are responsive to the increased use of information technology in financial reporting and accounting. Other market participants, however, may believe that the profession is abandoning the techniques that, in the past, made the financial statement audit a valuable tool for the protection for investors.

The primary focus of our concern, therefore, is whether today's audit model, with its emphasis on risk assessments and analyses instead of more intensive fact checking and verification of the numbers, can continue to assure investors that appropriate steps have been taken to provide them with reliable financial information. A review of this issue may involve a top to bottom examination of the "re-engineered" audit function, including, among many other things, the training of auditors, how audits are planned and supervised, whether firms' quality controls address all necessary elements in the new audit process, and whether the apparent decrease in audit documentation will impact the efficacy of peer reviews and other evaluations of audits.

As you know Al, before becoming Chief Accountant, I served as the Chief Financial Officer for a large technology company. Serving in that role drove home the reality that in order for an auditor to understand and appreciate fully the way management evaluates business risks and makes financial decisions, that auditor must have considerable business and professional experience. I am concerned that a substantial majority of the individuals performing audit work today, although some of the brightest graduates from our universities, do not have that experience. As the bulk of the audit work involves ongoing assessments of operations and associated risks, and how those risks might impact the reported results, this lack of practical business experience may have significant detrimental effects on the quality of audits. An inquiry into if, when, and how auditors bring partner-level and in-depth industry experience to bear in the audit process, therefore, would appear to be essential to an understanding of whether that process is continuing to protect investors.

Other questions might include whether the current audit model allows the auditor to de-emphasize or eliminate audit procedures that would have uncovered material financial statement misstatements, and whether there is a set of minimum detail-testing audit procedures that the auditor should not be permitted to eliminate under any new audit model or audit re-engineering.

As you know, our suggestion for a panel to review the new audit process is not an alarmist call to arms, but an effort to be proactive in making sure that all participants in the process work together to assure the continued protection of investors. As we discussed, I understand the POB will need to consider this request at its next Board meeting, along

Mr. A.A. Sommer
Page 3

with the accompanying logistical questions. I would be happy to respond to any further questions the Board and its staff might have on this very important project.

Al; I appreciate your and the POB's continued efforts on behalf of investors and I look forward to working with you in addressing the concerns identified in this letter, as well as other questions that may arise. I also look forward to discussing plans for forming and staffing the "blue ribbon" panel, and I am of course available to discuss these issues at your convenience.

Sincerely,



Lynn E. Turner
Chief Accountant

cc: Barry Melancon, President, American Institute of Certified Public Accountants
Deborah Lambert, Chair, Auditing Standards Board
Thomas Ray, Director, Audit and Attest Standards, American Institute of Certified
Public Accountants

Exhibit 2

PUBLIC OVERSIGHT BOARD

PANEL ON AUDIT EFFECTIVENESS

PANEL MEMBERS

CHAIR

SHAUN F. O'MALLEY

*Former Chair of Pricewaterhouse
LLP*

DENNIS H. CHOOKASZIAN

*Chair and CEO of CNA
Insurance Companies*

PAUL KOLTON

*Former Chairman and CEO of
the American Stock Exchange and
currently Chairman of the
Steering Committee of the EASB's
Business Reporting Research
Project*

BEVIS LONGSTRETH

*Counsel to Debevoise & Plimpton
and former Commissioner of the
SEC*

LOUIS LOWENSTEIN

*Simon H. Rifkind Professor
Emeritus of Finance and Law
at Columbia University*

ZOE-VONNA PALMROSE

*Ph.D., CPA,
PricewaterhouseCoopers Auditing
Professor, University of Southern
California*

AULANA L. PETERS

*Partner of Gibson, Dunn,
& Crutcher and former
Commissioner of the SEC*

RALPH S. SAUL

*Former President of the American
Stock Exchange and CEO of
CIGNA Corp.*

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January 6, 1999

The Public Oversight Board
One Station Place
Stamford, CT 06902

Members of the POB:

We are pleased to submit this letter outlining how we propose to address a project to examine whether the audit processes of large-firm members of the SECPS adequately serve and protect the interests of investors. Such a project was requested by Mr. Lynn E. Turner, Chief Accountant of the Securities and Exchange Commission, by letter of September 28, 1998 to Mr. A. A. Sommer, Jr., Chairman of the POB.

The purpose of the project is to make a comprehensive review and evaluation of the way independent audits are performed and assess the effects of recent trends in auditing on the public interest. The project will include, among other things, evaluating the adequacy of the professional development of auditors, how audits are planned and supervised, whether firms' quality control systems encompass the necessary elements and guidance, and whether audit documentation is appropriate. It also will consider the overall "tone at the top" and performance measures used by firms in evaluating audit personnel. Furthermore, the project will include assessing the need for possible changes in professional standards and the profession's self-regulatory process. In carrying out the project, we will consider users' expectations about auditors' responsibilities and the relationship between audit and non-audit services.

We anticipate that, as part of this undertaking, we will gather information and consider guidance materials recently issued or currently under development by the large-firm members of the SECPS and the AICPA. For example, the *Horizons* project of the Auditing Standards Board, we understand, contemplates evaluating the efficacy of the auditing standard relating to the detection of fraud and assessing the impact of audit reengineering on standards.

We envision that the project will be carried out in phases as described in the work program prepared by the Panel's staff members, culminating in a report that will be issued by the Panel. The report will identify the process undertaken, the resultant findings, and the basis for recommendations made to accounting firms, the AICPA, the Securities and Exchange Commission, audit committees, and managements.

Very truly yours,



Shaun F. O'Malley
Chair

Exhibit 3

**Panel on Audit Effectiveness
Public Hearings October 7/8, 1999
Timetable**

	<u>Thursday, October 7</u>	<u>Friday, October 8</u>
9:00 – 9:15	Opening Remarks, Shaun O'Malley	Opening Remarks, Shaun O'Malley
9:15 – 9:45	Arthur Levitt, Harvey Goldschmid, Lynn Turner, SEC	Michael Young, Willkie Farr & Gallagher
9:45 – 10:15	SEC, continued	Karen Pincus, AAA
10:15 – 10:30	Break	Break
10:30 – 11:00	Richard Rowe, Dan Goldwasser, Samuel Gunther, ABA Committee on Law and Accounting	Steve Samek, Joe Berardino, Greg Jonas, Arthur Andersen
11:00 – 11:30	Ed Jenkins, FASB	David Costello, NASBA
11:30 – Noon	Barry Melancon, AICPA	Jim Copeland, Deloitte & Touche
Noon – 1:00	Lunch Break	Lunch Break
1:00 – 1:30	Mike Conway, SECPS	Patricia McConnell, Bear Stearns
1:30 – 2:00	David Bershad, Milberg Weiss Bershad Hynes & Lerach	Dennis Nally, Bob Herz, PricewaterhouseCoopers
2:00 – 2:30	Phil Livingston, FEI	Steve Percoco, Lark Research Inc.
2:30 – 3:00	Peter Knutson, The Wharton School	Bob Herdman, Ernst & Young
3:00 – 3:15	Break	Break
3:15 – 3:45	Dom Esposito, Grant Thornton (on behalf of Grant Thornton, BDO Seidman, and McGladrey & Pullen)	Don Kirk, POB
3:45 – 4:15	Ernest Ten Eyck, Ten Eyck Associates	Closing Remarks, Shaun O'Malley
4:15 – 4:45	Bob Elliott, KPMG	
4:45 – 5:00	Closing Remarks, Shaun O'Malley	

**Report of the
Peer Review Process Task Force
Executive Committee
SEC Practice Section of the AICPA
January 25, 2000**

Purpose

The Peer Review Process Task Force (Task Force) was formed by the Executive Committee of the SEC Practice Section of the American Institute of CPAs (SECPS) in March 1999 for the purpose of determining ways of improving the effectiveness of peer reviews conducted under the SECPS peer review program. The formation of the Task Force and the need to reexamine the peer review program was encouraged by the SECPS Peer Review Committee (PRC), the Public Oversight Board (POB), and the staff of the Securities and Exchange Commission (SEC). These groups seek:

- enhancements in the reporting of the results of peer reviews;
- improvements in the effectiveness of peer reviews, for example by emphasizing the timely identification and testing of emerging issues and higher-risk areas during peer reviews;
- comprehensive governance and oversight of the peer review process; and
- peer reviews performed by appropriately qualified and trained reviewers.

Task Force Deliberations

A list of the Task Force members is attached. The members have the following affiliations:

- SECPS Executive Committee
- SECPS Peer Review Committee
- SECPS SEC Regulations Committee
- AICPA Peer Review Board
- AICPA Auditing Standards Board
- Nasdaq

Also participating in the deliberations of the Task Force was a member of the POB, staff of the POB, and staff of the POB's Panel on Audit Effectiveness. Additionally, members of the Task

Force met individually with several groups who are users of peer review reports, but were not directly represented in the deliberations of the Task Force, to obtain feedback from them regarding the peer review program. These meetings included representatives from the SECPS Quality Control Inquiry Committee, the U.S. Department of Labor, several State boards of accountancy, and several State CPA societies who administer the AICPA's Peer Review Program applicable to non-SECPS member firms.

Background and Objectives of the SECPS Peer Review Program

The origins of the profession's programs for voluntary self-regulation date back to 1977. Since then these programs have been continuously reviewed and enhanced with the changing practice environment and market conditions. Currently, SECPS member firms must have their quality control systems reviewed by independent peers once every three years. These reviews are system and compliance oriented with the objectives of evaluating whether:

- The reviewed firm's system of quality control for its accounting and auditing practice has been designed to meet the requirements of the quality control standards established by the AICPA.
- The reviewed firm's quality control policies and procedures were being complied with to provide the firm with reasonable assurance of conforming with professional standards.
- The reviewed firm was complying with the membership requirements of the SECPS in all material respects.

In a peer review, an independent team of CPAs, typically a firm-on-firm review, reviews the firm's stated quality control policies and procedures to determine whether they meet the elements of quality control set forth in professional standards. Then the review team tests whether the firm's personnel have consistently applied these policies and procedures by looking at specific engagements and compliance with firm-wide quality control systems, for example systems pertaining to independence, client acceptance, and professional development. The review team's conclusions are documented in a written report—which may be unmodified, modified or adverse—and, when appropriate, a letter of comments addressing matters that require action by the reviewed firm. The reviewed firm then responds to the letter of comments in writing, stating what corrective actions it intends to take.

The PRC establishes and maintains review standards. At regular meetings and through report evaluation task forces, the PRC considers each peer review, evaluates the reviewer's competence and performance, and examines every report, letter of comments, and accompanying response from the reviewed firm that states its corrective action plan before it is finalized. In its deliberations, the PRC may also question the peer review team or require the team to revisit the reviewed firm to perform additional procedures. The POB staff plays a key role in overseeing the performance of peer reviews working closely with peer review teams and the PRC. The working papers prepared on all peer reviews performed under the SECPS program are reviewed by the SECPS staff or POB staff.

Based on the nature of the peer review results, the PRC may require remedial measures beyond those contemplated in the reviewed firm's letter of response and require active monitoring of the firm's follow-up to assure that corrections are made. On some occasions, the PRC requires an accelerated follow-up peer review.

Once the PRC accepts them, peer review reports, letters of comments, and reviewed firms' responses are maintained in a file available to the public.

The SEC also oversees the SECPS peer review program and makes its own evaluation of the adequacy of the program and the POB's oversight of it. After the PRC accepts reports on the peer reviews of member firms with one or more SEC clients, the POB arranges with the SEC staff to review the POB's oversight files and the peer reviewer's working papers for a sample of the reviews based on the SEC access to working papers protocol set forth in the peer review standards. The SEC reports on its evaluation of the peer review program in its annual report to Congress.

Comments and Recommendations

After evaluating the current peer review program and obtaining feedback from various user groups, the Task Force reaffirmed the previously stated objectives of the peer review program. The structure for administering, conducting, and overseeing peer reviews should continue to strive for improvements in the performance of member firms' accounting and auditing practices and provide a means for fostering remedial actions when necessary. The Task Force also concluded that it is in the public's, and the profession's, interest to continue to have peer reviewers express opinions on the design of quality control systems and a firm's compliance with those quality control systems.

However, the Task Force identified four areas of the current peer review program that it believes should be improved. The four areas are: Reporting, Process, Governance and Oversight, and Qualifications and Training of Reviewers. The Task Force believes improvements in these areas will enhance the effectiveness of future peer reviews.

Reporting

Overview

Currently, individuals can request (either orally or in writing) the contents of the SECPS's public file which includes a member firm's three most recent annual reports, their most recent peer review report and, if applicable, the letter of comments and letter of response issued pursuant to their most recent peer review report, and the PRC's acceptance letter of such peer review. In addition, any actions required to be taken by the reviewed firm as a condition of acceptance of its peer review report are included in the firm's acceptance letter. Peer review reports and letters of comments are prepared based on the Standards for Performing and Reporting on Peer Reviews established by the PRC. Other communications regarding the results of peer reviews that are not

available to the public are made orally at exit conferences with firm management and in Summary Review Memoranda¹ presented to the PRC² (and available to the POB and SEC).

The Task Force believes that in order to best serve the public interest, the future peer review reporting model must be more transparent and better facilitate the communication of matters identified during peer reviews that should be addressed by reviewed firms and the profession. More transparent reporting would inform users of peer review reports and letters of comments about the conduct of peer reviews and expand the disclosure about the findings pertaining to the reviewed firms' quality control systems and compliance with those systems. The reporting model also should provide for the communication of best practices, constructive suggestions that go beyond professional standards, and matters for the attention of standards setters. To accomplish this, peer reviewers and reviewed firms should consider the PRC as the "audit committee" so that they have appropriate information to perform their functions effectively. Additionally, the future reporting model should provide appropriate access to information for the SEC staff to assess the effectiveness of the peer review program.

Recommendations

1. The SECPS should:
 - a. Continue to maintain a file that provides for public access to peer review reports, letters of comments, and the firms' responses to the letters of comments. We understand the SECPS is in the process of developing a system for including the documents contained in the public file on the Internet. The Task Force supports efforts to make the public file more accessible.
 - b. Study whether there are key quantitative and qualitative performance indicators that would be useful to users of SECPS member firms' annual reports or peer review reports. Such information might include, for example, the number of audits performed during the year compared to key qualitative indicators that are relevant, objective, and measurable.
2. The PRC should make changes to the Standards for Performing and Reporting on Peer Reviews for the following:
 - a. Revise the standard peer review report to more fully describe the peer review process and matters relevant to the specific peer review.

¹ The Standards for Performing and Reporting on Peer Reviews require that a Summary Review Memorandum be prepared on each peer review. The memorandum describes the planning of the review, the scope of the work performed, the findings and conclusions supporting the report and letter of comments issued, and the comments communicated to firm management during the exit conference that were not deemed of sufficient significance to include in the letter of comments.

² The Summary Review Memorandum is presented to the PRC for firms with 30 or more SEC clients or in instances where it is necessary for consideration by the PRC in accepting the applicable peer review report.

- b. Peer review reports should be addressed to the reviewed firm and the PRC to emphasize that peer reviewers and reviewed firms should consider the PRC as the “audit committee.”
- c. Require a Summary Observations Memorandum be prepared on all peer reviews that describes the peer reviewer’s observations regarding best practices, constructive suggestions that go beyond professional standards, and matters for the attention of standards setters. The Summary Observations Memorandum should be submitted to the PRC along with the other documents that are required to be submitted (all of which are available to the POB). To encourage candid communications, the Summary Observations Memoranda prepared on peer reviews each year should not be made available for public distribution, but should be used as a basis for preparing the PRC annual report described in Recommendation 4 c. The SEC staff should have access to the PRC annual report and, in its oversight role, should have access to the Summary Observations Memoranda on a no-name basis.

Process

Overview

As previously indicated, the PRC establishes and maintains the Standards for Performing and Reporting on Peer Reviews. Although there are approximately 1,300 SECPS member firms of various sizes and types of practices, the peer review standards are common to all member firms and do not provide for these differences. The Task Force believes the peer review process needs to recognize that not all firms are the same and adapt the peer review procedures accordingly. The peer reviews of larger, more complex firms with extensive quality control systems and internal inspection programs³ should have more frequent peer review involvement and eliminate redundancies with internal inspection programs. Further, the Task Force believes the peer review process needs to place greater emphasis on ascertaining auditor performance versus evaluating documentation to determine compliance with quality control systems and professional standards.

Recommendations

3. The PRC should make changes to the Standards for Performing and Reporting on Peer Reviews for the following:
 - a. There should be a prescribed differentiation of the SECPS member firms, based on the effectiveness and objectivity of the firms’ internal inspection programs. Tier A firms should be those that do not have an internal inspection program that meets specifically defined criteria for a Tier B firm. Tier B firms should be those firms that have an

³ The larger, more complex firms have established extensive internal inspection programs. These programs are designed to annually evaluate the adequacy of the firm’s quality control policies and procedures, its personnel’s understanding of those policies and procedures, and the extent of its personnel’s compliance with them. The inspection procedures performed are similar to those performed during tri-annual peer reviews. Such procedures place significant emphasis on reviewing engagements performed by a cross section of the firm’s accounting and auditing personnel.

effective internal inspection program that meets specifically defined criteria. The effectiveness of a reviewed firm's internal inspection program should be determined by the peer reviewer. The PRC, with the POB's oversight, should concur with the classification of firms.

- b. The peer reviews of Tier A firms should be systems and compliance oriented but place greater emphasis on the reviews of engagements, while the peer reviews of Tier B firms should involve reviews of engagements but place greater emphasis on systems and compliance.
- c. Tier B firms should be required to engage their peer reviewers to annually perform certain limited review procedures, in addition to the peer review performed on a tri-annual basis. The procedures performed by the peer reviewer on an annual basis should include: (1) follow-up on actions taken by the reviewed firm in response to the letter of comments, if any, and Summary Observations Memorandum from the most recent peer review, the Recommendations Letter (described below), if any, from the most recent annual limited procedures engagement, and the findings of the prior year internal inspection program; (2) review the design of any significant changes in the reviewed firm's system of quality control for its accounting and auditing practice; (3) review changes to the firm's policies and procedures designed to implement significant new professional standards; (4) review the plan for and results of the reviewed firm's internal inspection program, including determining whether it included consideration of emerging issues and higher-risk areas, and determine whether the reviewed firm has taken appropriate actions with respect to any engagements with material findings noted in the inspection program; and (5) if considered appropriate, prepare a Recommendations Letter communicating to the reviewed firm any observations and recommendations resulting from the limited procedures engagement. The Recommendations Letter would be sent to the PRC for informational purposes. However, if the peer reviewer determines that the firm has not taken appropriate actions with respect to material findings, the peer reviewer should refer such circumstances to the PRC for further consideration. Additionally, the POB should conduct oversight of the annual limited procedures engagement.
- d. The tri-annual peer review for Tier B firms should be integrated with the reviewed firm's internal inspection program in that year and focus on emerging issues and higher-risk areas, while relying on the internal inspection program (with some testing by the peer reviewer) to review routine and compliance areas. The reviewed firm's internal inspection program should become an integral part of the peer review in that the peer reviewer should review and approve inspection review procedures, review materials and questionnaires, and office and engagement selections made for the inspection program, and form joint teams of internal inspectors and peer reviewers for certain reviewed offices. The objectives of this more integrated involvement are to provide the peer reviewer with more direct, ongoing knowledge of the effectiveness of the firm's quality control systems and inspection program. Also, if the internal inspection program is determined to be effective, this approach allows the peer

reviewer to perform less routine and compliance review procedures and focus primary attention on the areas of higher-risk and emerging issues. For example, in some instances, peer reviewers might review on a surprise basis only those portions of engagements pertaining to emerging issues and higher-risk areas.

- e. The review materials and questionnaires should be revised to generate more qualitative, subjective, and judgmental considerations and findings by peer reviewers. The qualitative considerations by the peer reviewer should include in-depth interviews of the engagement team at all experience levels with respect to the approach taken in areas of higher-risk and emerging issues to provide a basis for judgmentally evaluating whether the engagement team possessed the necessary experience and appropriate information to adequately and timely plan and perform the audit procedures. Peer reviewers also should conduct focus group sessions with professional personnel at various levels in the organization in order to obtain candid feedback regarding critical matters pertaining to the accounting and auditing practice. The qualitative, subjective, and judgmental findings from these procedures should result in observations and recommendations regarding best practices, constructive suggestions that go beyond professional standards, and matters for the attention of standards setters to be included in the Summary Observations Memorandum in addition to potential findings for the letter of comments.

Governance and Oversight

Overview

The PRC is responsible for administering the SECPS peer review program by establishing standards for conducting and reporting on the results of peer reviews. The PRC also works closely with the POB in its oversight role. Although the AICPA Code of Professional Conduct does not specifically consider relationships between reviewers, reviewed firms, and clients of reviewed firms, the concepts concerning independence, integrity, and objectivity embodied in the Code are critically important to the peer review program. Likewise, oversight of the peer review program by the POB, and the SEC, makes the process both more effective and more credible.

The Task Force concluded that the overall structure for administering and overseeing the peer review program is primarily sound. However, the Task Force believes the effectiveness of future peer reviews would be improved with additional measures to promote peer reviewer independence and objectivity; changes to current protocols among the PRC, POB, SEC, and peer reviewers; and with greater depth in the POB's oversight of the performance of peer reviews.

The Statements on Quality Control Standards (SQCS) issued by the Auditing Standards Board (ASB) provide that firms have a system of quality control for their accounting and auditing practice and broadly describes elements of quality control and other matters essential to the effective design, implementation, and maintenance of the system. These standards, as well as generally accepted accounting, auditing, and independence standards and SEC rules and regulations in areas where such rules and regulations are pertinent, form the foundation of the systems oriented approach to conducting peer reviews. The Task Force believes that one of the

root causes of some recent criticisms of the peer review process relates to the lack of specificity of the SQCS.

Recommendations

4. The PRC should:
 - a. Make changes to the Standards for Performing and Reporting on Peer Reviews for the following:
 - i. Limit the peer review team captains for the reviews of Tier B firms to two consecutive reviews of the same firm and a total of three consecutive reviews as an engagement team member⁴. The primary purpose for limiting the team captain's total years of service is to enhance the benefit of the fresh-look obtained by rotating the peer review team captain.
 - ii. Require that peer review team captains for the reviews of Tier B firms participate in a meeting (exit conference) with the SEC staff and POB staff when the SEC staff reviews the firm's peer review working papers. The purpose of such a meeting is to timely discuss significant matters considered by the SEC staff during their oversight.
 - b. Prepare an annual report for the profession, standard setters (such as the ASB and FASB), regulators (such as the SEC), and others (such as the Professional Issues Task Force and SECPS Quality Control Inquiry Committee) that describes significant matters noted during peer reviews conducted during the year. Such report should highlight matters noted in letters of comments, Summary Review Memoranda, and Summary Observations Memoranda. The primary purpose of the annual report would be to facilitate the timely identification of matters that require the attention of the profession, standard setters, regulators, and others.
 - c. Determine a more formal means of identifying emerging issues and higher-risk areas in a timely manner, and providing frequent updates or supplements to the review materials and questionnaires used to perform peer reviews. The PRC should regularly seek formal input from the ASB, Professional Issues Task Force, SECPS Quality Control Inquiry Committee, POB, SEC staff, and others as to emerging issues and higher-risk areas that should receive focused attention by peer reviewers. The PRC, through a standing committee, task force, SECPS staff or otherwise, should prepare revisions or supplements to its review materials and questionnaires and timely distribute them to peer reviewers. We understand the SECPS is in the process of developing a system for including the review materials and questionnaires on the Internet. The Task Force supports efforts to make these materials easier to keep current and more accessible to peer reviewers.

⁴ Team captains are currently limited to three consecutive reviews of the same firm with no limit on the total years of service on the engagement team.

- d. Study the cost versus benefit of more frequent peer reviewer involvement for Tier A firms in order to improve the effectiveness of the peer review process for these firms. More frequent peer reviewer involvement might include limited review procedures similar to those described in Recommendation 3 c for Tier B firms.
- e. Establish a more formal means for continuously pursuing better approaches to performing peer reviews. Such means might include, for example, periodically conducting focus group sessions with experienced peer reviewers and users of peer review reports or having a limited number of experienced peer reviewers experiment with different review techniques on some peer reviews.

5. The POB should:

- a. Perform an in-depth review of its current approaches to overseeing the performance of peer reviews with the goal of identifying ways of gaining more timely and deeper involvement by the staff and Board. Guidelines for enhancing such approaches should include the following:
 - i. The nature, timing, and extent of the POB staff's oversight role should vary based on an assessment of such factors as size, complexity, and risk profile of the firm's accounting and auditing practice.
 - ii. The POB staff's oversight of the performance of peer reviews should be timely and include the scope of the review, evaluation and resolution of issues identified during the review, and communications of the results of the review. The scope of the review includes consideration of the number of and specific engagements and offices to be reviewed; the significant accounting, auditing, and independence areas to be emphasized during the review; and the approach to integrating the firm's internal inspection program.
 - iii. The POB staff's oversight of the performance of peer reviews should be more timely and extensive for Tier B firms. More timely involvement would include, for example, increasing beyond its current level the oversight of the work of peer reviewers as it is being performed rather than reviewing the work once it is completed. More extensive involvement would include, for example, participation with a peer reviewer in some interviews of audit engagement team members and in focus group sessions with office personnel.
- b. Consider establishing a process for obtaining additional expertise to assist the POB staff, when necessary, in formulating the staff's views on significant matters that occasionally arise during the performance of peer reviews. The purpose of establishing such a process would be to provide a means of drawing on

experienced professionals and subject matter experts to assist in evaluating matters where significant differences of professional judgment exist between the peer reviewers, reviewed firm, and/or POB staff.

6. The Task Force understands the ASB is planning a project to improve the SQCS. The Task Force believes that an expansion of the standards to include more specific guidance is an important element to achieving continuous improvement and strongly supports the ASB's efforts.

Qualifications and Training of Reviewers

Overview

The Standards for Performing and Reporting on Peer Reviews describes the qualifications and training requirements for peer reviewers. The Task Force believes the standards appropriately address the essential requirements of the peer review team such as confidentiality; independence, integrity and objectivity; competence; organization of the review team; and qualifications for individuals who serve as reviewers and of the reviewing firm. However, the Task Force also believes that the current training courses and approach to training peer review team captains and reviewers needs to be enhanced. There are currently two courses offered by the AICPA to peer reviewers, How to Conduct a Peer Review Under the AICPA Practice-Monitoring Programs ("How to Course") and the Advanced Training Course for Reviewers: Current Issues in Practice Monitoring ("Advanced Course"). Individuals who want to participate as a team captain on a peer review are required to attend a training course at least once every five years. The courses are developed by authors contracted with by the AICPA and are offered through various State CPA societies.

Almost all peer reviews are firm-on-firm peer reviews. However, in a few instances, Committee Appointed Review Teams (CARTs) are formed to perform the review. CARTs are typically formed for reviews of small firms so that the review team has appropriate specialized skills. For example, a CART may have a team captain from one firm and a reviewer from another firm in order to have a review team member who is knowledgeable in a particular specialized industry. Currently, the PRC establishes the fee schedule for CARTs. The Task Force believes a market driven fee arrangement between the CART and the firm being reviewed would result in more qualified reviewers willing to participate on a CART.

Recommendations

7. The PRC should:
 - a. Establish a standing task force that will oversee the peer review training programs to ensure that the training programs and methods of delivering them meet the needs of the peer review program. The task force should address the following:
 - i. The content and method of delivering peer review training courses to ensure that the training is relevant and timely. To determine the content of training programs, considerations should be given to the competencies

required to perform effective peer reviews. Such competencies would include interviewing skills, diagnostic skills, knowledge of the peer review process, as well as, knowledge of generally accepted accounting, auditing, and independence standards and SEC rules and regulations in areas where such rules and regulations are pertinent to the engagements being reviewed. Also, alternative training methods should be considered such as via the Internet, CD-ROM, or tele-conferencing.

- ii. The process for identifying and selecting course instructors and for monitoring the instructor's performance should be formalized.
 - iii. Consideration should be given to developing more continuous training programs for team captains.
- b. Develop a system for evaluating the performance of team captains. Such a system might include a written evaluation of the team captain's performance by the SECPS technical reviewer and, when applicable, POB staff for each peer review. The results of such evaluations could then be summarized on a periodic basis to identify team captains who are not performing at an acceptable level so that appropriate actions can be considered by the PRC.
- c. Discontinue setting rates for peer reviews conducted by CARTs. Fees for participating in a CART review should be established by the firm being reviewed and the members of the review team.

Attachment

Task Force Members and Other Participants Peer Review Process Task Force Executive Committee SEC Practice Section of the AICPA

Task Force Members

Richard L. Miller, Chair	Ernst & Young LLP	SECPS Peer Review Committee
Edmund Coulson	Ernst & Young LLP	SECPS SEC Regulations Committee
George Diacont	Nasdaq	
Bradley R. Gabosch	Arthur Andersen LLP	SECPS Peer Review Committee
Daniel J. Hevia	Hevia, Beagles & Company	SECPS Peer Review Committee
Wayne A. Kolins	BDO Seidman LLP	SECPS Executive Committee
Deborah D. Lambert	Johnson, Lambert & Co.	Chair, Auditing Standards Board
Dale P. Lien	McGladrey & Pullen LLP	SECPS Peer Review Committee
Anthony D. Lynn	Davis, Lynn & Moots P.C.	AICPA Peer Review Board
Guy W. Moore, Jr.	Deloitte & Touche LLP	SECPS Peer Review Committee
Edward F. Smith	KPMG LLP	SECPS Peer Review Committee
David J. Steiner	Ehrhardt, Keefe, Steiner & Hottman PC	SECPS Peer Review Committee
W. Ronald Walton	PricewaterhouseCoopers LLP	Chair, SECPS Peer Review Committee

Other Participants

Michael A. Conway	KPMG LLP	Chair, SECPS Executive Committee
Donald J. Kirk	Public Oversight Board	Board member
Jerry D. Sullivan	Public Oversight Board	Executive Director
Charles J. Evers	Public Oversight Board	Technical Director
Thomas M. Stemlar	Public Oversight Board	Staff, Panel on Audit Effectiveness

AICPA Staff

Susan S. Coffey	Vice President - Self Regulation & SECPS
David Brumeloe	Director - SECPS
Sheri Fabian	Senior Technical Manager, SECPS
Dean Beddow	Technical Manager, Peer Review
Al Perazzo	Technical Manager, SECPS

Exhibit 5

**Panel on Audit Effectiveness
Public Hearings on Exposure Draft of
Report and Recommendations
Timetable**

	<u>Monday, July 10</u>
9:30 – 9:40	Opening Remarks, Shaun O'Malley
9:40 – 10:30	Arthur Levitt, Lynn Turner, SEC
10:30 – 10:45	Break
10:45 – 11:15	Daniel Dustin, New York State Board of Accountancy
11:15 – 11:45	Steve Samek, Joe Berardino, Greg Jonas, Arthur Andersen
11:45 – 12:15	K. Michael Conaway, William Treacy, Texas State Board of Accountancy
12:15 – 1:15	Lunch Break
1:15 – 1:45	Jim Turley, Bob Herdman, Ernst & Young
1:45 – 2:15	Thomas Sadler, Washington State Board of Accountancy
2:15 – 2:45	Ian Plaistowe, Jon Grant, The Auditing Practices Board (UK)
2:45 – 3:15	Jim Schiro, Ken Sicchitano, PricewaterhouseCoopers
3:15 – 3:30	Break
3:30 – 4:00	David Costello, Dennis Spackman, NASBA
4:00 – 4:30	Thomas Craig, Professor, Illinois State University
4:30 – 5:00	Jim Copeland, John Fogarty, Deloitte & Touche

	<u>Tuesday, July 11</u>
9:00 – 9:15	Opening Remarks, Shaun O'Malley
9:15 – 10:15	Barry Melancon, Dan Jones, Jim Gerson, AICPA
10:15 – 10:30	Break
10:30 – 11:00	Mike Conway, KPMG
11:00 – 11:30	Andrew Wingate, Diana Hillier, Canadian Institute of Chartered Accountants
11:30 – Noon	William Bishop, Bill Duane, Institute of Internal Auditors
Noon – 1:00	Lunch Break
1:00 – 1:30	Larry Gelfond, Colorado State Board of Accountancy
1:30 – 2:00	Rick Antle, Professor, Yale School of Management
2:00 – 2:30	Gerard Sokolski, William Stocker, Julian Jacoby, New York State Society of Certified Public Accountants
2:30 – 2:45	Closing Remarks, Shaun O'Malley

